



Joint Committee on Financial Services
Testimony of Massachusetts Public Banking in support of S.632/H.975
An Act to Establish a Massachusetts Public Bank

Chairs Feeney, Murphy, and members of the committee,

Massachusetts Public Banking is a volunteer organization whose mission is to have the state create a public bank that will:

- Address racial, gender, and geographic inequities in financing,
- support our small businesses and farms,
- strengthen our municipalities,
- help address climate impacts, and
- make loans in cooperation with local banks and CDFIs.

Partners in the coalition include the Boston Ujima project, The Boston Foundation, the Boston Impact Initiative, Environmental League of Massachusetts, the Metropolitan Area Planning Council, Neighbor to Neighbor, 350MASS and many others. Our leadership includes activists, banking experts, attorneys, economists, and community development experts.

Massachusetts Public Banking **strongly supports** *S.632/H.975*
An Act to Establish a Massachusetts Public Bank and urges you to favorably report it out of the committee.

Public banking provides a structural solution to a structural problem: the shortfall in credit that haunts underserved neighborhoods, low-income residents, and communities of color in Massachusetts, as well as our municipalities, small and women-owned businesses, farmers, climate change entrepreneurs, and other deserving borrowers. Those needs are particularly sharp today given the high interest rate environment. The record shows that existing creditors, including commercial banks, cannot meet these needs on their own. Again, current conditions exacerbate the problem, as commercial banks struggle with long-held low-yield assets. By contrast, a Massachusetts public bank could use banking capacity to reach the unmet financing needs of credit-worthy borrowers. The public bank would work in cooperation with local private banks, CDFIs, and state-based quasi-public agencies.

The bank will be established with a legislative appropriation of \$200 million in capitalization spread over four years and with \$1.4 billion in deposits transferred by the state treasurer from funds that are not used for the state's day-to-day operations. Those funds are currently invested at relatively modest yields in the Massachusetts Municipal Deposit Trust, which in turn invests the

funds across the country and around the world. Bringing the revenues back to Massachusetts, the bank will be able to make loans worth approximately \$1.3 billion at sustainable rates of interest to help meet the shortfall in affordable credit.

Establishing the public bank allows the commonwealth to harness the financial power of banking: data provided and explained by financial experts on our team demonstrate the economic advantages of establishing a bank compared to other financing options such as loan funds (e.g., green banks) and the cost savings enjoyed by a public bank compared to commercial banks. Much of the financing will occur through partnerships, including participation loans, with those banks and CDFIs. That will strengthen those lending institutions and spread the benefit of their expertise. The design thus allows the public bank to expand access to credit for underserved borrowers sustainably and with strong safeguards against risk.

The public bank is accountable to the commonwealth through its Board of Directors chaired by the state treasurer or their designee and to the public through its Board of Advisors representing a diversity of interests. Transparency to all parties is ensured by a robust set of provisions on reporting, auditing, and conflict of interest, as well as by supervision through the Massachusetts Division of Banks.

We urge the Joint Committee on Financial Services to report these bills with a favorable recommendation for passage so that the state can harness the power of modern finance to serve the people of Massachusetts and to remedy our chronic gap in access to credit. The testimony that follows is organized in three parts:

- Part I. The problem the public bank is meant to address.
- Part II. The solution the public bank will provide.
- Part III. The ways in which the public bank would complement and strengthen existing private and public lending in Massachusetts.

Our key takeaways are as follows:

1. Our banking system structure leaves certain borrowers without adequate capital:
 - Business owners of color face limits given inherited disadvantage that reduces their access to affordable credit. Many such businesses are small, which makes it more costly for banks to offer credit; some businesses also require technical assistance that commercial banks do not offer.
 - Women-owned small businesses face similar disparities, resulting in fewer and more expensive loan opportunities.
 - Many small businesses have started or re-started operations after the pandemic. Others are still recovering from its economic impact. Many such enterprises do not grow rapidly and may require long-term affordable loans.
 - Similarly, many small farms require long-term, low-cost credit in the face of some of the highest real estate values in the nation and unpredictable income.
 - The unique structure of cooperatives and land trusts limits their ability to obtain funding from commercial lenders.
 - Climate change initiatives like community solar installation and energy efficiency retrofits face unique challenges in obtaining financing.

- Lastly, municipalities are struggling to obtain their funding needs from the bond market and from private bank credit, and the structure of bond market funding hampers flexibility in responding to changing community needs.
2. The public bank provides a structural solution to these shortfalls:
 - The structure of banks enables them to lend at lower rates than other lenders, and the public bank will harness these rates for lending in the public interest.
 - The public bank will have significant savings that it can pass on in the form of affordable financing: it will have reduced operating costs compared to commercial banks because it is servicing one large depositor (rather than thousands of individual depositors) and its business model maximizes the use of its partners' expertise. These substantial cost savings will be used to offer lower rates on loans and build up loan loss reserves.
 - The public bank will have a robust framework to manage credit and liquidity risk. It will be supervised by the Massachusetts Division of Banks.
 - The public bank will require only \$200 million in appropriations, allocated in \$50 million increments over four years. After this initial appropriation, the bank will be self-sustaining. To fund its deposits, the state treasurer will incrementally shift \$1.4 billion in state revenues, a small portion of the state's deposits currently held in the Massachusetts Municipal Depository Trust (MMDT).
 3. The public bank will complement existing lenders in Massachusetts:
 - It will work collaboratively with local banks and CDFIs. It will not compete with commercial banks because it will not accept deposits from individuals or private entities.
 - Its mission and capacity are different from existing quasi-public entities including MassDevelopment and Mass Capital Growth Corporation, with which it can work in cooperation.

I. The Problem: A Structural Shortfall Has Left Deserving Borrowers Starved of Credit and Capital

A. Communities of Color Have Long Had Unequal Access to Credit and Capital

Black-, Brown-, immigrant-, and Indigenous-owned businesses have long faced unequal access to credit because of discriminatory practices. That heritage has depressed personal and family wealth so that many businesses owned by people of color are undercapitalized relative to white owned businesses.¹ Functionally, this means that even though almost as many people of color start businesses as do white people, rates of business ownership among people of color are far below the average because more than half of these businesses are unable to stay in business due to lack of affordable financing.² The pre-pandemic estimated capital gap for business owners of color in Massachusetts is at least \$574 million per year.³ Reflecting the fact that this annual gap accrues over

¹ See Boston Indicators, [The Color of the Capital Gap](#) page 5.

² See *id.*; see also [U.S. Census Bureau 2018 Annual Business Survey](#).

³ See Boston Indicators, [The Color of the Capital Gap](#) page 2. The \$574 million figure is based on pre-pandemic 2019 data including the U.S. Census Bureau, [Small Business Credit Survey Report on Minority Firms](#) and the Federal Reserve Bank of Atlanta, [Small Business Credit Survey Report on Minority-Owned Firms](#). It represents the additional annual

multiple years, bridging that gap requires several billions of dollars. Nationally, the rates of unmet credit needs among entrepreneurs of color is 15-25% higher than those of white entrepreneurs.⁴ The Color of the Capital Gap report by Boston Indicators and the Boston Foundation identifies a state public bank as a valuable potential source of increased small business loans for entrepreneurs of color: by collaborating with local funding institutions, a public bank enables them to increase their reach and decrease their lending risk.⁵ The Boston Foundation has formally endorsed creation of a Massachusetts Public Bank.

B. Cities and Towns Require a Lower Cost of Capital to Invest in Infrastructure

Massachusetts cities and towns have relied primarily on the bond market to raise money for capital expenditures for many years, but the bond market has been failing to meet the infrastructure funding needs of local communities.⁶ The bond market has multiple inflexibilities that hamper municipalities: it requires that programs needing funding must be completely envisioned and described in bond documents. Furthermore, once a bond is sold, the terms are immutable, depriving the municipality of the ability to adapt to changing circumstances or unforeseen municipal needs. Additionally, low-income municipalities with lower credit ratings may have a harder time issuing bonds with favorable rates.⁷

Because of the limitations of the bond market, more and more cities and towns, especially in low-income areas, have become reliant on private bank debt to supplement severe funding shortfalls from the bond market.⁸ For a number of reasons, reliance on these commercial bank loans can make it harder for cities and towns to secure cheaper credit from the bond market in the future, indicating that there is an important role for the public bank to play as a collaborator with existing funders.⁹

Despite the existing bond market and private credit sources, cities and towns face acute unmet funding needs, and the pandemic and subsequent economic downturn have worsened the situation by cutting tax revenues significantly. The commonwealth's public housing is one example of the dire need for affordable municipal credit: Massachusetts currently has \$3 billion in public housing capital needs, which doesn't include building a single new unit of public housing.¹⁰ Presently, \$150 million of ARPA money has been allocated to public housing, leaving \$2.85 billion

amount business owners of color would have received if they had enjoyed a similar access to credit as their white counterparts.

⁴ Id.

⁵ Id., page 19.

⁶ See Tax Policy Center, [Briefing](#); In 2018, 58% of state and local issuances were revenue bonds, 36% were general obligation bonds, and 6% were private placements.

⁷ See [GAO 2012 Report on Municipal Securities](#) page 16. Factors affecting the credit quality, and therefore market value, of a security include municipalities' credit ratings, principal and interest payment histories, and draws on debt service reserves. Credit quality assessments hold greater weight among broker-dealers since the post-2008 collapse and subsequent scarcity of bond insurance.

⁸ See Brookings, [Working Paper on Privatization of Municipal Debt page 1](#): "state and local governments have increased their bank loan obligations from about \$30 billion before the financial crisis to over \$160 billion in late 2016;" see also Federal Reserve Board, Claim Dilution in the Municipal Debt Market: Municipalities with a larger share of bank loans tend to have lower household income and lower debt-to-income.

⁹ Id. page 14: reliance on private bank debt may lead to claimholder conflict between private banks (who have higher priority credit) and pre-existing public bond holders (whose claims on cash flow are diluted), resulting in public bondholders who are less likely to receive the full value of their bonds.

¹⁰ See CHAPA, [Priorities for State ARPA Funding](#).

in unmet funding needs.¹¹ Massachusetts also has an estimated \$10.2 billion in unmet drinking water infrastructure financing needs; assuming the Infrastructure Investment and Jobs Act allocates approximately \$1.1 billion to drinking water infrastructure, a significant financing gap persists.¹² Although funding on that scale is beyond the scope of the public bank acting alone, the public bank can be one of several funding sources working to chip away at this gap. The situation is similar for all municipal infrastructure. The public bank, in partnership with other funding entities, can be an important resource for municipal projects.

C. Current Conditions Particularly Challenge the Small Business Sector

Small businesses have long suffered from inadequate access to credit. According to pre-pandemic numbers nationally, 51% of small businesses face unmet funding needs.¹³ And as above, entrepreneurs of color alone in Massachusetts are missing more than \$574 million each year in unmet credit needs.¹⁴ Current economic conditions exacerbate that problem. Rising interest rates, in particular, place a disproportionate burden on small businesses, 70%¹⁵ of which express concern about that trend. A recent Goldman Sachs study¹⁶ compared the debt costs for small and large businesses. It found that in 2021 they added up to 6 percent of revenues for small businesses and only 2 percent for large businesses.

One reason for the discrepancy is that large businesses can borrow via the issuance of bonds, and issuance has climbed with rising interest rates; small businesses lack this option.¹⁷ Many small businesses also cannot lock in low rates from lenders over the longer term; they enter periods of stress without credit cushions. More generally, small companies have more trouble getting loans because they are seen as more vulnerable to revenue downturns in hard times.¹⁸ Start-up costs are even more prohibitive. The shortfall is devastating to local communities as small businesses are a significant source of innovation and creative enterprise.¹⁹

Those problems have long been recognized. During a period of high interest rates in 1982, the House of Representatives conducted a hearing titled “Impact of high interest rates on small business capital formation.”²⁰ One of the witnesses, Dr. Leon Taub, an economist, stressed the detrimental impact of high interest rates on small businesses, saying “small businesses are often

¹¹ See CHAPA, [Governor Baker Signs ARPA Spending Bill with \\$600 Million for Affordable Housing](#); see also [Healey-Driscoll Administration Unveils \\$4 Billion Affordable Homes Act to Increase Production and Lower Costs](#) (discussing plan that would invest 1.6 billion in the repair, rehabilitation and modernization of public housing).

¹² See the [Massachusetts Water Infrastructure Finance Commission Report](#) page 29; see also the [Massachusetts Infrastructure Investment and Jobs Act Fact Sheet](#).

¹³ See [Baker-Polito Economic Recovery Plan](#).

¹⁴ See Boston Indicators, [The Color of the Capital Gap](#) page 2.

¹⁵ Metlife and U.S. Chamber of Commerce, [Special Report on Inflation and Supply Chain Shocks on Small Business](#) (2022).

¹⁶ [The Impact of Higher Rates on Small Businesses](#) (Abecasis/Hill).

¹⁷ Dion Rabouin, [Fed Rate Increases Hit Small Businesses the Hardest](#), WALL ST. J. (2023).

¹⁸ Alexandra Scaggs, [Are Small businesses in big trouble](#), FINANCIAL TIMES (2023).

¹⁹ See Patricia Greene, [How Small Business Owners Are Leading the Country in Innovation](#), INC. (2016).

²⁰ [Impact of High Interest Rates on Small Business Capital Formation](#): Hearing before the Subcommittee on Tax, Access to Equity Capital, and Business Opportunities of the Committee on Small Business, House of Representatives, Ninety-seventh Congress, Second session, (1982).

found in those industries which are sensitive to high interest rates”²¹ and that “Small businesses, with their small asset bases and short credit histories, are squeezed particularly severely [when interest rates are high].”²² He also noted that small businesses are the ones growing the most rapidly, facing the largest increases in receivables and capital needs, and are thus hurt as much or more than stable businesses.²³ Additionally, “high interest rates create a period of economic adversity in which the odds are stacked heavily in favor of large firms which can withstand even several years of an unfavorable economic environment.”²⁴

The current stress follows the difficulties caused by the COVID-19 pandemic. By the end of 2020, 37% of small businesses in the state had closed their doors, and small business revenue had dropped by 44%. Those unable to pivot to a low-customer-contact model or allow employees to work from home were especially hard hit. Federal relief programs like the Paycheck Protection Program (PPP) have channeled aid through private banks which service their established clients first, leaving “unbanked” or “underbanked” businesses out in the cold.²⁵

These PPP grants illustrate the manner in which the existing financial infrastructure can perpetuate disparities: low-income communities received only two thirds of the number of PPP grants provided to high-income communities.²⁶ Additionally, only 28% of small businesses consisting of 1-4 employees received the entire grant they applied for, compared to 44% of businesses with 5-49 employees and 59% of businesses with 50-499 employees.²⁷ Furthermore, the distribution of PPP grants heightened racial disparities among small business owners of color, who are less likely to have established relationships with local commercial banks.²⁸

Finally, the current moment has left even those commercial banks in weakened condition. They hold assets, including loans, mortgages, and long-term securities (Treasuries and mortgage-backed securities) that generate only low yields (often below 3.5%). Yet the costs they face for deposits is rising. The difficulties faced by SVB and First Republic Bank last spring were extreme, but even soundly capitalized community banks face stresses similarly caused by the whiplash in interest rates.

Despite federal and state recovery plans, the need for capital among these sectors and small businesses more generally persists because the shortfall in access to credit is chronic. A public bank could support small businesses -- and the creditors that lend to them -- across changing economic conditions.

²¹ Id., page 8

²² Id.

²³ Id.

²⁴ Id.

²⁵ See Rachel Atkins, Lisa Cook & Robert Seamans, [Discrimination in lending? Evidence from the Paycheck Protection Program](#), page 2; “the program was administered using established financial institutions and initially relied heavily on commercial banks to distribute the funding.”

²⁶ See Federal Reserve Bank of Cleveland, [How Well Did PPP Loans Reach Low- and Moderate-Income Communities?](#) While formally stylized as a loan program, PPP loans were forgivable, and therefore acted as grants. Banks making PPP loans are not subject to credit risk from borrowers. See generally, SBA, Paycheck Protection Program Loans FAQ (2021).

²⁷ Id.

²⁸ See Brookings, [New Data Shows Small Businesses in Communities of Color Had Unequal Access to Federal COVID-19 Relief](#) (2020).

D. Farmers Need Affordable Financing for Prohibitively High Land Costs

Interviews we carried out with small farmers in Massachusetts indicate a strong need for access to affordable and longer-term credit than afforded by federal programs. Massachusetts farms are historically small and family-run: 94.2% of farms in Massachusetts are small farms, and 79.7% of farms are family or individually owned.²⁹ Farmers face a land cost crisis that predates the pandemic but has worsened since then: Massachusetts has the fourth highest agricultural real estate values in the country, and the average annual net income per farm has been falling steadily from 2020 through 2023.³⁰ Current programs offering assistance are unable to fully address the problem. The Farm Service Agency's Farm Loan officers are not eager to offer credit to farmers looking to purchase high cost land and grow a low-return crop, and FSA loans are disproportionately denied to women farmers and farmers of color.³¹ Local programs like the Agricultural Preservation Program (APR) and Chapter 61A are relatively inflexible and both are unavailable to small farms under 5 acres, which excludes a significant portion of farms in Massachusetts.³² Unable to pay mortgages, farmers have been forced to sign year-to-year leases or get priced out of the business altogether.³³ Farmers reported that better access to affordable credit with multi-year repayment windows would enable equipment investments and collaborations that could infuse affordable local food into lower-income communities.³⁴

E. Women-owned Businesses Face Funding Disparities

The credit gap for women-owned enterprises existed pre-COVID, but it has been exacerbated. Examples of the need for and lack of access to credit are broad. Sixty-two percent of women entrepreneurs depend on their business as their primary source of income.³⁵ Yet only 4% (one out of every 23 dollars) in community bank loans go to women-owned businesses nationally.³⁶ Indeed, even among Small Business Administration (SBA) loans designed to promote access to credit, women owned businesses receive only 40% of the funds received by men owned businesses.³⁷ Overall, women's businesses, that tend to be younger, receive fewer loans for higher rates. A public bank will address these inequities.

²⁹ See Mass.gov, [Massachusetts Agricultural Resources Facts and Statistics](#).

³⁰ See UMass Amherst Center for Agriculture, Food, and the Environment, [Farm Real Estate Values](#) per 2017 Massachusetts Agricultural Census; see also USDA, [Highlights from the September 2021 Farm Income Forecast](#).

³¹ See [GAO Report on Agricultural Lending](#); the Biden Administration planned to allocate \$4 billion in Coronavirus aid to [loan forgiveness for farmers of color](#), but the policy was deemed to be [unconstitutional](#).

³² See UMass Amherst Center for Agriculture, Food, and the Environment, [Massachusetts Agricultural Data: Most Farms are Small Farms](#); 1-9 acre farms make up almost 33% of Massachusetts farms (the U.S. Agricultural Census does not collect data further disaggregated within the category of 1-9 acres). [Chapter 61A](#) enables farmers to pay lower property taxes on their land in exchange for maintaining a portion of undeveloped land; taxes are assessed based on agricultural value instead of development value. The [APR](#) offers to pay landowners the difference between the fair market value and the agricultural value of the land in exchange for a deed restriction ensuring non-development. The Massachusetts Farm Bureau [APR Survey](#) indicates that the program is too restrictive for many; complaints include barriers to farmer and worker housing, composting, having commercial horse operations, agritourism, and prohibitions on renewable energy.

³³ See Edible South Shore, [Priced Out of the Market](#).

³⁴ Per interviews by Nancy Ryan with farm owner Andy Pollock, Silverbrook Farm, N. Dartmouth, MA on 3/11/2021 and farm owner and State Rep. Paul Schmid on 3/24/2021.

³⁵ See SCORE, [Women's Entrepreneurship](#), Spring 2018.

³⁶ See 2014 Senate Report, [21st Century Barriers to Women's Entrepreneurship](#) page 10.

³⁷ Id.

F. Climate Mitigation Projects Require Multiple Sources of Financing

Low-income affordable housing residents could benefit greatly from the cost savings and energy resilience of solar combined with energy storage. For example, the density of affordable homes in resident owned manufactured housing cooperatives makes them attractive places for solar and other shared energy projects. These are loans in which a public bank could participate with a CDFI to bring clean energy to moderate income homeowners in parks. These projects also involve significant energy cost saving to the residents. Other potential collaborators in these solar and storage projects can include agencies such as Climate Ready Boston, a government initiative to get Boston ready for the long-term impacts of climate change.³⁸ There may also be opportunities to partner with private investment companies such as Sunwealth and Blue Hub Capital in financing projects in low-income neighborhoods in Cambridge and Boston.³⁹

Direct loans, participation loans or loans to CDFIs are also required to fund solar panel purchases and to provide upfront capital for solar companies to finance the cost of equipment and labor.⁴⁰ Unlike the private sector, non-profit and public-sector institutions are blocked from monetizing the federal tax incentives that pay for a significant capital portion of a solar project. Through solar power purchase agreements, a nonprofit organization or municipality is paired with a private solar investor who can take advantage of the federal tax programs. The nonprofit organization or municipality “hosts” a solar system and purchases the solar power at a competitive electricity rate from the private sole investor. The “host” has no upfront costs and has the option to acquire ownership of the PV system after five years at a price significantly less than the installation cost. A public bank could make loans to private solar investors to help fund solar projects.

The Problem, Summarized

The shortfall in credit and capital to the groups above is a structural problem. Private banks cannot resolve the problem because the profile of those groups makes it harder to lend to them for commercial profit. Thus, decades of discriminatory treatment leave a racial wealth gap that saddles the Black and Latinx community, driving up their need for capital. The same handicap means that many entrepreneurs of color do not have collateral to offer. Many such businesses are small and/or need technical assistance, attributes that raise costs for banks or fall outside their services. Other businesses in low-income communities or rural areas are slow- growing, requiring affordable financing over a long-term. That kind of lending falls outside the parameters of most commercial banks. Small farms face similar obstacles and are getting priced out of the industry. Women-owned enterprises face similar constraints. Other borrowers, like cooperatives and land trusts, have ownership structures that require tailored attention, again raising obstacles for commercial lenders. Climate change initiatives also face unique challenges in borrowing. Finally, banks do not lend readily to cities and towns except on certain kinds of collateral, given the difficulties collecting from them. The lack of bank financing leaves cities and towns to navigate bond markets that can be both limited and expensive. The COVID-19 pandemic and inflationary period that followed has

³⁸ See [Climate Ready Boston Executive Summary](#).

³⁹ See Boston Globe, [Four Leaders Fighting for Clean Air, Clean Energy, and a Healthy Future for Boston](#).

⁴⁰ A \$200,000 loan participation a NH CDFI thus allowed it to purchase a portion of a royalty loan to Encore Redevelopment LLC, based in Burlington, VT. See [Encore Renewable Energy receives \\$1 million from impact investment funds to expand solar projects in New England](#). Encore is an integrated clean energy company focused on commercial, industrial, and community- scale solar PV systems and solutions for underutilized property.

heightened the crisis for each of these communities and has made their financial needs even more acute.

Thus, even those banks most committed to equitable lending today face an impasse: they cannot lend adequately to borrowers who clearly merit credit, but require more capital, entail more risk, and cost more to service.

II. The Solution: A Public Bank Will Provide a Structural Solution to Our Structural Problem

A. The Public Bank Will Harness the Capacity of Commercial Banks

Public banking provides a structural solution to the structural shortfall in lending by fusing the capacity of a bank with the reach of the public.

The solution begins with banking because banks have unparalleled capacity as lenders. Their business model allows them to lend at lower rates than other lenders. Most basically, banks occupy a privileged place in our monetary system. The payments system in which banks participate creates a network that allows them to extend their own liabilities in the form of monetary promises, commonly known as bank deposits. Those deposits, reciprocated in offsetting ways across the network, do the work of money.⁴¹ Day in and day out, we use them at the grocery store, to pay our rent, and to receive wages. And because we use deposits as money, we do not require banks to pay us a high rate on these deposits as we do for regular debt and equity claims.⁴² By contrast, non-bank lenders need to fund their lending by raising expensive equity and long-term debt. A recent New York Fed report found the long-run difference between banks' and non-banks weighted average cost of capital at 6%.⁴³ Effectively, deposits allow banks to enjoy high leverage, extending eight to ten times as much in loans as their equity, and borrowing (through deposit liabilities) at exceptionally low rates.

⁴¹ Networked reciprocity between commercial banks allows each lending bank to issue deposits against loans far in excess of its reserves and other liquid assets. As we detail below, a public bank would enjoy the same networked reciprocity, although the logistics of its deposit issues and settlement would work slightly differently.

⁴² Popular willingness to use deposits as money, without expecting interest on them, is furthered by federal deposit insurance provided by the FDIC, but does not depend upon it. FDIC insurance is limited to accounts up to \$250,000 (FDIC, [Deposit Insurance FAQ](#)). Rates on uninsured deposits (about 40% of the US. total, see [FDIC Quarterly Q2 2023](#), p.23, FRED, [Deposits: All Commercial Banks](#)) remain extremely low. Conversely, people do expect interest on treasury securities although they are guaranteed by the full faith and credit of the federal government (the 5-year treasury fluctuated between 1-5% in recent years, while yields on large deposits fluctuated between 5-25 bps (see FRED, [Yield on UST 5Y](#); [National Rate on Jumbo Deposits](#) (>\$100k, 1 Month CD)). In other words, the yield on deposits is a function of the fact that they offer services as money, not their government guarantee, although that guarantee supports individuals' confidence in the banks. FDIC insurance is not relevant for the public bank, given its low ceiling (\$250,000), as is also the case for the Bank of North Dakota.

⁴³ Kovner and Van Tassel, [Evaluation Regulatory Reform: Banks' Cost of Capital and Lending](#), page 36 ("The second column (2) indicates that bank WACC-Rf is almost 6% lower than non-bank WACC-Rf on average, reflecting the high leverage and low interest rates of banks relative to non-banks"). "WACC-Rf" denotes that the risk-free rate is subtracted from the weighted average cost of capital (WACC). Given that the 6% figure reflects a comparison between banks and non-banks, the risk-free rate cancels in the calculation. The period studied in the paper is 1996-2017 (page 9).

With a lower cost of capital, banks can lend at lower rates relative to other lenders who do not use the same deposit-based business model.⁴⁴ This point is illustrated by rates on small business loans. In 2021, banks offered small businesses credit at average annual interest rates between 2.58%-7.16%, while the respective figure for online or alternative lenders is 13%-71%.⁴⁵ The import of the rate difference is clear: access to bank lending provides credit that is absolutely crucial to borrowers.

Massachusetts can—and should—take advantage of the same business model available to banks. Establishing a public bank will allow the legislature to allocate a finite amount of capital – and then leverage that capital effectively and sustainably to support a much larger amount of lending. The deposit base for the public bank already exists; the state treasurer need only transfer a small portion of existing state funds currently held, mainly out-of-state, in the Massachusetts Municipal Deposit Trust (MMDT). The public bank will then be able to make financing available at low rates – indeed lower rates than commercial banks can afford to extend.⁴⁶

Finally, the public bank will enable additional and profitable lending by those banks, as well as community finance development institutions. The legislation directs the public bank to work through participation loans wherever possible. The model will create a uniquely powerful initiative between public and private partners.

To be clear, we support public banking because we believe banking is a critical aspect of our financial system and the strength of the Massachusetts economy. We believe in public banking as a supplement – not a substitute – for private banking because private banking alone does not satisfy the banking needs of all communities.

Specifically, the bill proposes that the legislature appropriate \$200 million in capital over four years to a newly chartered public bank. The public bank will be well within regulatory requirements (a capital-to-asset ratio of 1-to-11) if it leveraged its capital at a ratio of about 1-to-8.⁴⁷ In other words, for every dollar in appropriated capital, the public bank will hold \$8 in assets while operating very cautiously. In order to populate the public bank with deposits, the state treasurer will transfer \$1.4 billion in existing state funds from the MMDT. This represents a small portion – under 10% – of total MMDT funds held by the state.⁴⁸ As discussed below (II.D) the MMDT balances represent “slow money” that is not used for day-to-day payments (e.g., payroll) by the state treasurer. The

⁴⁴ Federal Reserve Board of Governors, [2019 Small Business Consumer Survey](#) page 4: “...more than half [online lender applicants] saying they experienced high interest rates, and almost a third reporting concerns with unfavorable repayment terms.”

⁴⁵ ValuePenguin, [Average Small Business Loan Interest Rates in 2021](#): Comparing Top Lenders. Annual percentage rates by individual lenders include American Express (business loan) 6.98%-19.97%, BlueVine (business loan) 15%-78%, and Funding Circle 9.49%-30.12%. In addition to the difference in cost of capital, the difference between banks and online/alternative lending rates is attributable in some part to more flexible underwriting compared to very strict underwriting by banks. As discussed below (II.C), the public bank’s cost savings, and collaboration with CDFIs would also allow it to responsibly provide more inclusive underwriting.

⁴⁶ See *infra* II.C. Cost savings the public bank would enjoy are above and beyond that of private commercial banks.

⁴⁷ See, e.g., [12 CFR §208.4, Regulation H](#) which will apply to the public bank as a member of the Federal Reserve System; *infra* II.D.

⁴⁸ The Massachusetts [2022 Annual Comprehensive Financial Report](#) page 83: MMDT balances of \$23.66 billion for government-wide total and \$7.56 billion for fiduciary funds. These amounts are exclusive of additional balances in MMDT by local government. Per its [website](#), total current (Nov. 2023) MMDT balances are \$32.2 billion.

transfer under the legislation will leave untouched all funds that the state holds in accounts kept for daily transactional business in commercial banks, including under the Move Money program.⁴⁹

With \$200 million in capital, and \$1.4 billion in deposits, the public bank will have assets of \$1.6 billion. Assuming a significant buffer kept for liquidity management, the bank will be able to make \$1.3 billion worth of financing available (see stylized balance sheet below). Moreover, that financing will come at low rates, given the deposit-based business model that allows significant lending against limited capital.

In fact, the public bank will be able to lend at rates even lower than commercial banks. Three features of the public bank’s design make this possible.

First, compared to commercial banks, the public bank will have lower operating costs. On its liabilities side, it will service only one depositor—the commonwealth—and it will not undertake that depositor’s daily transactional work.⁵⁰ The public bank will also have lower operating costs on its asset side. As above, the public bank will do most of that work through intermediaries. As the legislation directs, the public bank will partner with Massachusetts banks and community development financial institutions, extending financing through participation loans whenever appropriate.⁵¹ Those entities are expert in finding and supporting worthy borrowers; the public bank will increase their ability to do just that by providing affordable financing. Consequently, the public bank will not need to spend the same money as a commercial bank in deciding which loans to extend. Finally, given that the public bank is part of state government, the public bank will pay lower salaries. It will attract qualified candidates who are passionate about public banking.

Second, the public bank will save on interest costs to its sole shareholder, the state. For the past decade, the MMDT funds have earned a low average return of just under 1%.⁵² The opportunity cost of shifting them to the public bank is low, and as discussed below (II.E) will be easily recouped.⁵³

Third, given its ownership by the state, the public bank will be able to target a more modest return on equity than the one required by shareholders in private banks. As we detail below, this

⁴⁹ See Section 9(b); see also [2020 Annual Comprehensive Financial Report](#) page 82 (“fast money” deposits in commercial banks amounted to \$1.35 billion).

⁵⁰ As above, the public bank would not interfere with or change the arrangements that the Commonwealth currently has to service its daily transactional work.

⁵¹ See Section 14(h).

⁵² See MMDT Cash Portfolio, [Returns](#) (2013-2022). Data is reproduced below for convenience (a money fund’s returns are expressed as its Net Asset Value or NAV).

	Average	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV	0.96%	1.82%	0.11%	0.70%	2.42%	2.10%	1.20%	0.66%	0.25%	0.18%	0.19%

⁵³ For further discussion see II.E. below. In a nutshell, since 2013, the MMDT balances have been earning an average yield of only 1% (see above), such that the opportunity cost of shifting them would be \$14 million annually (= \$1,400*1%). This cost is very small compared to Massachusetts’s total revenue of about 60 billion (see [MA Comprehensive Annual Financial Report](#) (2020), p. 48). The cost will also be easily recouped thanks to the new economic activity the public bank’s lending would generate. With a 5% flat income tax rate, new wages of \$280 per year (93 positions at \$30,000) would fully cover the cost. The state also has a 6.25% transaction tax. Given the scope of public bank lending (about \$1,300 million), and comparative figures on employment creation by CDFIs, the cost will be more than offset.

savings will amount to around 2.8% of assets on an annual basis. That is a large savings that the bank can channel to eligible borrowers by providing them with affordable financing.⁵⁴

In short, the commonwealth can deploy the power of the banking business model by establishing a public bank. But while the public bank will have the capacity that comes with banking, it will lend differently.

The public bank will reach precisely those deserving borrowers who have a great need for credit (see above) but fall outside the parameters that constrain commercial banks. Those borrowers are expressly targeted by the bill: Section 12 identifies recipients who are eligible for funding. Eligible recipients include:

- businesses with sustainable business models that are small or slow-growing – the food truck or neighborhood hair salon
- small and medium-sized farms and the industries, like mechanics and supply stores, that support them
- the Community Development Financial Institutions, and related economic development organizations with the know-how to find, vet, and support local entrepreneurs through technical assistance
- cities and towns, along with municipal and state quasi-publics
- land trusts
- cooperatives
- entities created to pool funds for affordable housing development, and those developing housing or preservation projects when existing funders agree that gap financing is needed

Note that local commercial banks will identify and originate participation loans to many borrowers and are therefore listed in Section 12 as well.

In addition to defining the universe of eligible recipients, the legislation (Section 14) sets out clear priorities for financing. Importantly here, the priorities direct attention to just the groups who are credit-starved, including those devastated by the COVID-19 Crisis and hampered by rising interest rates. In particular, the public bank will reach entrepreneurs from underserved communities, those subject to historic and current economic inequities, and will also direct funding to women entrepreneurs. The public bank will support cities and towns, like the Gateway Cities, that are striving to build safe infrastructure, including improvements to transportation, food security, and public safety. Looking forward, the bill prioritizes financing to entities that address the impacts of climate change. And cognizant of escalating income inequality, the bill directs support to businesses with equitable wage structures. All funding is to be distributed across Massachusetts to both urban and rural regions, with support extended to smaller towns in the application process.

By deploying the capacity to lend as a bank and reaching those worthy borrowers currently shut out, the public bank represents a potent solution to the chronic shortfall that leaves communities starved for credit. In the next section, we provide further detail on the opportunities for public bank collaboration with existing lenders by casting a spotlight on CDFIs.

⁵⁴ The term “affordable financing” is defined in Section 13 of the bill.

B. Spotlight: The Public Bank and CDFIs

One of the key ways the public bank will provide affordable financing is through collaboration with Community Development Financial Institutions, or “CDFIs.” CDFIs are specialized lenders whose mission is to serve the needs of low-and-moderate income (LMI) communities where the high demand for capital is not met by existing banks (see I.A). Certification by the US Treasury requires CDFI activities to be “...purposefully directed toward improving the social and/or economic conditions of underserved people... and/or residents of economically distressed communities.”⁵⁵ One of the keys to CDFIs’ success is the provision of technical assistance and training that helps ensure borrowing is sustainable, and considerably reduces the risk of default.⁵⁶ Technical assistance provided includes financial or credit counseling, homeownership counseling, and business planning and management assistance, and is a formal legal requirement for CDFI certification by the US Treasury.⁵⁷ CDFI rates to borrowers are about the same as bank rates – but they lend to customers typically not served by banks because the banks deem the loans to be too risky or not profitable.⁵⁸ CDFIs promote diversity by increasing lending to persons of color and women (60% and 50% of lending respectively).⁵⁹ Reflecting the close relationship between CDFIs and the communities they serve, CDFIs’ staff and leadership are also highly diverse, setting them apart from the documented lack of diversity in the banking sector.⁶⁰

Massachusetts is currently served by 28 CDFIs holding over \$2.2 billion in assets.⁶¹ The activities of these CDFIs demonstrate there is an unmet demand for financial products that could be provided by the public bank. First, Massachusetts CDFIs are 86% deployed – a remarkably high number.⁶² For comparison purposes, banks in Massachusetts, on average, deploy under 70% of their

⁵⁵ See [12 CFR § 1805.201](#) (Certification as a Community Development Financial Institution).

⁵⁶ See Swack et al., [CDFI Industry Analysis: Summary Report](#) (2012), p.9. (“To the extent that the CDFI industry could define a common business model, it might be described as follows: CDFIs provide loans that traditional capital markets are unlikely to provide (because they are smaller or more affordably priced, for instance) to borrowers who are unlikely to be served by traditional markets (because they are perceived to be, or in fact are, riskier or are systemically underserved), and yet the CDFIs show strong portfolio performance by providing high-touch “development services” to educate and counsel the borrower. The downside of this business model is that operating costs are driven up because CDFIs market, underwrite, and originate smaller loans, and provide more intensive services.”)

⁵⁷ See [12 CFR §§ 1805.104, 1805.201](#).

⁵⁸ See OFN, [Side by Side](#) (2019) page 5–6. Average CDFI lending rates for 2019 were 6%. While average commercial bank rates were slightly lower, it is hard to draw a meaningful comparison between an bank loan and a CDFI loan that bank will not make. If the bank made the same loan, based on a risk-based pricing model, the bank rate would likely be much higher than the CDFI rate. CDFIs have various ways of effectively reducing and managing their risk, including the provision of technical assistance (see note 47) and capital and loan loss reserves (discussed below).

⁵⁹ See OFN, [Side by Side](#) (2019) page 6: CDFIs are particularly important in serving the Black-owned firms. According to TBF, [The Color of the Capital Gap](#) report page 17: “Seventeen percent of Black-owned firm applicants applied at CDFIs, compared to 5 percent of White-owned, 4 percent of Asian-owned, and 3 percent of Latinx-owned applicants”. TBF further reports (p.17) that small business lending per capita is much lower in Massachusetts than it is nationally (\$6.64 compared to \$20.79).

⁶⁰ OFN, [Side by Side](#) (2019), page 23: According to 2019 data, 43% of CDFI employees were diverse and 58% were women. These levels are only slightly lower among management and board members: (minority and women management respectively) 40% and 37% (minority and women board members respectively) and 39% and 47%. For an empirical study of lack of diversity in the banking industry, see Committee for Better Banks, [Advancing Racial Justice for Frontline Bank Workers](#) (2021).

⁶¹ This was the total assets of the 15 CDFIs who participated in the Massachusetts CDFI (2021) survey by Swack and Massachusetts Public Banking.

⁶² Swack and Massachusetts Public Banking, Massachusetts CDFI (2021). A deployment ratio is defined as loans and leases divided by total assets.

funds in loans and leases.⁶³ What this means is that CDFIs are getting money into businesses, affordable housing and community facilities. A survey of 15 CDFIs in Massachusetts, conducted in 2021, shows that in addition to being fully deployed, over half say that they have urgent or somewhat urgent needs for more capital. A public bank could help meet this need by providing long-term low-cost lending to CDFIs and also lend on larger projects in partnership with them.⁶⁴

In working with CDFIs, the public bank can help address the unmet demand for capital, while still managing risk effectively. By lending directly to CDFIs, for example, the bank benefits from the fact that CDFIs have an excellent track record of serving LMI communities while successfully managing risk, as evidenced by very low losses. Over the past 20 years, CDFIs' delinquencies and charge-offs have been equivalent to those of banks.⁶⁵ Additionally, CDFIs maintain strong balance sheets, further reducing risk. For example, CDFIs maintain leverage ratios of about 24% as opposed to under 10% for banks.⁶⁶ CDFIs average loss reserves for 2019 (a fund made to absorb losses without reduction to capital) were 2.87% compared to 1.2% by banks. This strong capital position, in addition to funded loss reserves, makes loans to CDFIs very safe investments for the public bank.

In short, a public bank in Massachusetts can collaborate with CDFIs to help plug a large capital gap, particularly in LMI communities. The bank will also be able to effectively manage its risks in this business line.

Table 1: CDFIs' successful track record in managing risk

Measure	A. CDFIs	B. Commercial Banks
1. Delinquency rate (2019)	1.08% ⁶⁷	0.90% ⁶⁸

⁶³ [FFIEC's State Average Report](#) (2021) (Massachusetts commercial banks' average deployment ratio is 67.5%, listed as Balance Sheet %, Net Loans & Leases (as percentage of assets)).

⁶⁴ 86% of survey respondents reported they would like more opportunities to co-lend with banks. 93% are interest in 10 year loans at 3% or lower.

⁶⁵ For figures, see Table 1. The delinquency rate measures the portion of loans and leases that are more than 90 days past-due as a percentage of total loans and leases. The charge-off rate measures the portion of actual credit losses on loans as a percentage of total loans and leases.

⁶⁶ A leverage ratio is defined as capital (shareholders equity) divided by total assets. See figure in Table 1.

⁶⁷ See OFN, [Side by Side](#) (2019), page 6.

⁶⁸ See FDIC, [FDIC Quarterly Q4 \(2019\)](#), page 3.

2. Delinquency rate (2010-19)	2.26% ⁶⁹	3.50% ⁷⁰
3. Cumulative Charge-off (1999-19)	0.76% ⁷¹	0.92% ⁷²
4. Leverage Ratio	24% ⁷³	10% ⁷⁴
5. Loan Loss Reserves (2019)	2.87% ⁷⁵	1.18% ⁷⁶

C. The Public Bank Will Have a Powerful Business Model

In this section, we detail the feasibility of the public bank by comparing its operation with the operation of commercial banks. The Public Bank's business model will harness the basic capacity of commercial banks (II.A. above) and will improve on it through additional cost savings. These cost savings will allow the public bank to provide affordable financing in ways that are not available to private banks acting alone.

The feasibility of the public bank's business model is best evidenced by reviewing a high-level projection of its financial statements. For ease of reference, a stylized balance sheet of the public bank is included below.

MA Public Bank		
\$1.6 billion About \$1.3 billion in loans (§§ 12-14) and \$300 million liquidity buffer	Assets	Liabilities
		\$1.4 billion Deposits (§9) Held by MA Treasurer
		Equity \$200 million Held by Commonwealth (§8)

With this basic balance sheet in mind, we consider the public bank's projected income statement. That pro forma demonstrates the public bank's ability to provide affordable financing while still turning a modest profit at the end of the year. Our exercise includes three steps. First, we consider the income statements of private Massachusetts banks to create a baseline for comparison.

⁶⁹ Calculations based on OFN, Side by Side report figures compiled for the [2010-2019 period](#), and reproduced below for convenience.

	Avg.	2019	2018	2017	2016	2014	2013	2012	2011	2010	2009
CDFI delinq. %	2.29%	1.08%	1.34%	1.81%	1.25%	1.50%	1.70%	2.40%	2.70%	3.50%	5.60%

⁷⁰ FDIC, [FDIC Quarterly Q4 \(2019\)](#), Chart 4 (figure estimated based on graph).

⁷¹ OFN, [Side by Side \(2019\)](#), page 5.

⁷² FRED, [Charge-Off Rate on All Loans](#), All Commercial Banks (figure represents and average across the period).

⁷³ OFN, [Side by Side \(2019\)](#), page 5.

⁷⁴ FDIC, [FDIC Quarterly Review Q2 \(2020\)](#), page 5, core capital (leverage) ratio, Table I-A. Commercial banks' "total risk-based capital ratio," which is a more refined measure of risk, was higher at 15.7% (id at 8), but still considerably below CDFIs' leverage ratio of 24%.

⁷⁵ OFN, [Side by Side \(2019\)](#), page 5.

⁷⁶ FDIC, [FDIC Quarterly Review Q1 \(2020\)](#), page 8, Table IV-A ("loss allowance to: loans and leases").

Second, we project the cost savings the public bank will enjoy relative to private Massachusetts banks. Third, we show how the public bank can use these cost savings to promote affordable finance in ways that are not possible for private banks acting alone.⁷⁷

Step# 1: Baseline: Income Statements from Private Massachusetts Banks

The following income statement figures are taken from the FFIEC's (Federal Financial Institutions Examination Council) peer group report of all insured commercial banks in Massachusetts, and is representative of the overall performance of these banks.⁷⁸ The peer group report is a commonly used tool by regulators and bank management. We present average figures from 2018, about one year prior to the beginning of the COVID-19 pandemic. This year was chosen to represent a macroeconomic environment with low, but positive interest rates (average Fed funds rate of 2%).⁷⁹ For ease of exposition, and following the peer group report format, amounts below are expressed as percentage of banks' assets.⁸⁰

- Income: Prior to COVID-19, private Massachusetts banks earned a total income of 4.4% of assets. The vast majority of that income (86%) came from the interest income that private Massachusetts banks earned, primarily on their loans and leases. The average rate banks charged from borrowers was also 4.4%.⁸¹
- Expenses: Private Massachusetts banks' expenses were 3.4% of assets. The vast majority of expenses (2.7% of assets) were operating costs also known as "non-interest expense" that include wages to employees, leasing branches, IT, marketing, etc.⁸² Private Massachusetts banks also had a small interest expense of 0.7% to compensate depositors and other creditors. A third type of expense, "provision for credit losses" is made for losses that banks anticipate on their loans. Provision for the year under examination was only 0.1%.⁸³
- Net income: Private Massachusetts banks' net income (=income – expenses) amounted to 1% of assets.⁸⁴
- Return on equity: Private Massachusetts banks' return on equity was 8.9% (net income of 1% of assets divided by equity of 11.3% of assets).⁸⁵

⁷⁷ The paragraphs below use several accounting terms that may not be familiar to readers. A corporation's income statement includes its income, expenses, and net income over an accounting year. "Income" is revenue received by the corporation. "Expenses" are costs borne by the corporation. "Net income" is the difference between income and expenses. For a bank, most income is derived from interest on loans ("interest income"), and most expenses are associated with operating costs ("non-interest expense"). To get a sense of a bank's profitability, net income is often divided by equity to produce a "return on equity" (ROE). That ROE represents the rate of return a bank's shareholders have earned as compensation for their investment. Note that ROE is not expressed as portion of bank assets.

⁷⁸ The peer group report can be accessed on [FFIEC's website](#) (MACOM—All Insured Commercial Banks in Massachusetts, 12/31/18).

⁷⁹ We will be glad to reproduce this analysis with a time series or extend it to include different scenarios if such analysis would be of value to the Committee.

⁸⁰ Figures are rounded to the first decimal.

⁸¹ "Yield on total loan and lease" under Non Int Inc, Exp, Yields.

⁸² Summary ratios.

⁸³ All figures in this paragraph are from the Summary Ratios.

⁸⁴ Summary ratios. For simplicity of exposition, we are using pre-tax net operating income. Net income (after tax) was 0.8%. Return on equity calculations also use pre-tax net operating income as their denominator.

⁸⁵ For "return on equity" see note 68 above. We remind readers that ROE is not expressed as a % of assets, as those cancel out when dividing net income by equity (each of the above being themselves calculated as % of assets).).

This review of the income statement illustrates a basic reality. The way that private banks price their loans (the interest income they generate) needs to be sufficiently high to cover expenses and a return on equity. One of the causes for lack of access to credit is that the interest rate charged on loans is simply too high for many socially valuable projects.⁸⁶ The results of our Massachusetts CDFI survey suggest most CDFIs cannot afford to pay interest rates greater than 3% even on 5-year debt.⁸⁷ It is easy to see that with loans needing to earn an average rate of 4.4%, loans to CDFIs at 3% would not be commercially attractive to banks.⁸⁸ To make affordable financing possible, the public bank will not only harness the capacity of private banks, but improve on it through unique cost savings. As we discuss below, the same basic dynamic applies not only to rates, but to the low levels of risk private Massachusetts banks undertake, and to the relatively short loan maturities they extend.

Step #2: Cost Savings to the Public Bank

As explained above, the public bank's projected cost savings derive from three sources: lower operating costs, foregone interest expense on state treasurer deposits, and a lower return on equity. Here, we elaborate on these savings, and provide data-based projections on their size. See Appendix for figures, sources of data, and notes.

- **Operating costs:** The public bank's operating costs will be considerably lower than private Massachusetts banks. First, by having only a single depositor (the state treasurer) the public bank will save on the high costs private banks incur to serve retail customers including paying tellers, operating branches, maintaining sophisticated IT systems, marketing etc. Second, by working through intermediaries (see discussion in III.A), the public bank will save on similar costs involved in originating retail loans. Third, as a publicly owned entity, the public bank will limit the amount of executive compensation it pays.

While the exact size of the public bank's operating cost savings cannot be projected with certainty, we can get an indication of their scope by studying another public bank, the Bank of North Dakota. We used data from the past decade (income statements 2019, '17, '15, '13, '11) to compare the operating costs of the Bank of North Dakota (BND) to Massachusetts banks. For simplicity of exposition, we calculate each of their operating costs over a given year as a proportion of that year's assets. The data demonstrates that while Massachusetts banks' annual operating costs over the period were 2.78% of assets, BND's were only 0.45%.⁸⁹ The annual savings on operating costs therefore amount to 2.3% of assets annually. This difference reflects a much more favorable efficiency ratio to BND compared to private Massachusetts banks.⁹⁰ To control for the possibility that the difference in operating cost is driven primarily by a difference

⁸⁶ This is not to ignore other reasons, many of which are described in Part I of this testimony.

⁸⁷ 63% of respondents rejected a 3%-5-year rate-maturity mix, choosing lower rates instead as those acceptable to them.

⁸⁸ Note that lending for non-commercial motivations, like CRA compliance, is very limited in scope. Less than 3% of bank asset counted towards CRA compliance (2016 figures; calculation based on total of \$419 billion counting towards CRA compliance from the [Urban Institute](#), divided by \$16 trillion in commercial bank assets from [FRED](#)).

⁸⁹ See Appendix, Tables 1-2.

⁹⁰ The efficiency ratio is calculated as non-interest expense divided by operating income after provision for loss. The lower the efficiency ratio, the more efficient the bank, because it is producing the same amount of interest income (denominator) at a smaller cost (numerator). Over the past decade, BND's average efficiency ratio was only 20.6% compared to private Massachusetts banks' average efficiency ratio of 73% (See Appendix A, Tables 1-2). The national average is 67.7% (see [FFIEC](#), National-All bank in nation, 09/30/2019).

in living expenses between the two states, we compared BND's operating costs to those of North Dakota commercial banks over the same period.⁹¹ The result remains very similar, meaning the operating cost saving is unlikely to be driven by the cost of living differential.⁹² Nevertheless, to account for two other technical controls, we have adjusted the 2.3% cost saving by dividing it by a margin of safety of 1.4. Even with this adjustment, the cost living differential between states demonstrates that the projected savings on operating costs remain substantial at 1.6% of assets ($=2.3\%/1.4$).⁹³ In what follows, we use that lower (and more conservative) estimate.

- Foregone interest on deposits: The bill (Section 9(d)) provides that the state shall not receive interest on its deposits at the public bank. This represents an additional annual saving of 0.7% of assets compared to Massachusetts private banks. Rather than interest on deposits, Massachusetts receives a built-in financial return as a taxing authority that is investing in the state. By meeting presently unmet demand for capital, the public bank will create new jobs and sales in Massachusetts. For every dollar of new income/sales so created, Massachusetts recoups at least 5 cents (income and sales are currently taxed at a flat 5% and 6.25% respectively). Taking the \$14 million in interest on MMDT balances as our benchmark ($=\$1,400 \text{ million} \times 1\%$ average yield), the commonwealth recoups the full interest with only \$280 million in new income and sales ($=\$14 \text{ million} / 5\%$ tax rate). As discussed below (II.E), this is a high likelihood given the public bank's size (\$1.6 billion) and comparative data from mission lenders.⁹⁴
- Return on equity: The fact that the public bank's only shareholder is the commonwealth will allow it to target a lower return on equity than private banks. For example, by targeting a more

⁹¹ During the period under consideration (the 2010s), Massachusetts was 1.2 times more expensive than North Dakota (see Bureau of Economic Analysis, [Regional Price Parities by State and Metro Area](#) ($=108/90$, reflecting the fact that Massachusetts and North Dakota had average values of 108 and 90 percent of the national price level respectively).

⁹² Private North Dakota banks had average operating costs of 2.6% over the period, which is close to 2.8% private Massachusetts banks. See Appendix Tables 1, 3. North Dakota Banks' efficiency ratio is somewhat lower than private Massachusetts banks, an average of 62.9% compared to 73.4%, but still far above BND's 20.9%. Given that operating costs as % of assets are similar (the numerator in the efficiency ratio), the difference is driven by higher rates on North Dakota bank loans (e.g., due to a less competitive banking market) rather than a cost of living differential.

⁹³ The first control we used was to compare the deployment ratio of BND and private Massachusetts banks. That ratio measures the share of loans and leases as a total proportion of a bank's assets. The comparison controls for the fact that loans and leases involve higher operating costs compared to securities and central bank reserves (a bank's main non-loan assets). We find that over the period, BND had a lower deployment ratio than private Massachusetts banks, 58.8% as compared to 69.6%. To eliminate this possibility altogether, we can deflate the difference in operating cost by a margin of safety of 1.18 ($=70\%/59\%$). See Appendix, Table 5. The second control accounts for the possibility that the FFIEC data we are using is not asset weighted. Smaller banks generally have higher efficiency ratios, so the lack of asset weighing could skew the result in that direction. We note that this control is not strictly necessary, because many of the private Massachusetts banks the public bank would support are smaller banks, facing the higher efficiency ratios. Nevertheless, to control for the size effect, we calculated the difference between the 2019 national FFIEC data and 2019 (see note 81) national FDIC data (that has a lower efficiency ratio, and therefore appears to be asset weighted). This leads to a margin of safety of 1.19 ($=\text{the } 67.7\% \text{ FFIEC figure divided by the } 56.7\% \text{ FDIC figure (see } \text{FDIC Quarterly Q2 2020, page 8})$). The total margin of safety from the two controls combined is therefore 1.4 ($=1.18 \times 1.19$).

⁹⁴ Our calculations on opportunity cost assume the relatively low interest rate environment prevailing during 2013-19 (where data on MMDT yields is available). We believe the basic conclusion would hold in a higher rate environment given the large size of additional tax income relative to the opportunity cost (see II.E for further discussion). We also note that if this were an area of concern for the committee, as the sole shareholder of the bank, the commonwealth could always recoup the opportunity cost of foregone interest by targeting a slightly higher rate of return on its investment. At any event, as our calculations above demonstrate, forgone interest represents a relatively small portion of the public bank's cost savings and does not affect its basic financial model.

modest 5% rather than a 8.9% return on equity, the public bank can save an additional 0.5% of assets annually.⁹⁵

In sum, through lower operating costs, foregone interest on deposits, and a lower return on equity, the public bank's cost savings compared to private Massachusetts banks are projected at 2.8% of assets annually (see summary in Table 2 below). 2.8% of assets is a large amount. Recall that the net income that guides private banks' incentives is 1% of assets annually (see previous section). As we describe below, the public bank can use these savings to support affordable financing.

Table 2: All figures as % of assets

	Private MA banks	Public Bank	Net difference
Operating costs	2.7%	0.9% ⁹⁶	1.6%
Interest on deposits	0.7%	0%	0.7%
Net income	1%	0.5%	0.5%
Total	4.3%	1.4%	2.8%

Step #3: Using Cost Savings to Support Affordable Financing

The public bank will use its cost savings to support affordable financing in several ways – providing lower interest loans to eligible borrowers, building up loan loss reserves to responsibly engage in more inclusive lending, and extending maturities through responsible hedging. The following paragraphs provide a broad sense of how these tools may be used, keeping in mind that the specific details, and mix between tools, will be determined by the public bank's management based on the objectives of its business plan (see discussion in II.E.).

- Reducing rates on loans: As noted above, the annual 2.8% cost saving will allow the public bank to lend at rates that are commercially unsustainable for private banks. For a CDFI needing credit at 3% or below, the public bank's ability to provide low-cost debt will facilitate CDFI lending that would not have taken place otherwise. All things equal, the public bank can reduce its rates by up to 2.8% compared to a hypothetical commercially driven loan, while still maintaining a 5% ROE. For example, in the environment discussed above, with a 4.4% average charged on commercial loans, the public bank can price its lending as low as 1.6% ($=4.4\% - 2.8\%$), while adding a small amount for expected loan losses (see discussion below).
- Building up loss reserves: Loss reserves are a “contra-asset” that banks use to provide for anticipated losses on their loans and leases. With higher loss reserves, a bank can responsibly make loans that have, or are perceived to have, greater expected losses. Such higher

⁹⁵ Assuming a leverage ratio of 1-to-8, a reduction of 5% in ROE leads to a saving of 0.5% of assets ($=5\%/8$).

⁹⁶ The 0.9% figure was calculated as follows. To provide a margin of safety, the 2.3% difference in operating cost between BND and private Massachusetts banks was deflated by 1.4, resulting in a deflated difference of 1.6% ($=2.3\%/1.4$). The deflated difference was then subtracted from private Massachusetts banks' operating cost of 2.7% ($1.1\% = 2.7\% - 1.6\%$).

perceptions of risk are common (even if they are at times unfounded⁹⁷) with respect to borrowers with limited credit history, lack of collateral, or non-traditional legal status (like cooperatives). These are often the kind of loans most required in underserved communities and private banks shy from making them. By building its loss reserves, the public bank will be able to purchase participations in such loans from CDFIs and community banks.

Data shows that loan loss reserves by Massachusetts banks over the 2011-19 period have been only 0.95% of loans and leases.⁹⁸ This represents a low tolerance for risk, even in comparison to the national average of 1.44% in reserves.⁹⁹ The data suggests the Massachusetts banks' lending is highly limited to the very safest loans. All things equal, the public bank can lend at similar rates to Massachusetts private banks, while using the 2.8% cost saving to build loan loss reserves, while still maintaining responsible risk management. To give a stylized example, if the public bank lent at 4.4%, over a three- year period, it would accumulate a much higher loan loss reserve of 8.4% ($=2.8\% \times 3$ years). The public bank could then make loans with capacity to absorb expected losses of 2-3%, while still maintaining risk management metrics that are more prudent than national commercial banks.¹⁰⁰

- Extending loan maturities: Many borrowers require loans with longer maturities than those offered by private banks. CDFIs, for example, struggle to find patient funding for the long-term credit needs of their own borrowers (51% of respondents in our Massachusetts CDFIs survey expressed demand for 10-year loans at 3%).¹⁰¹ Meanwhile, less than 14% of private Massachusetts banks loans are for maturities greater than 5%. Private banks are reluctant to make longer-term loans due interest rate risk.¹⁰² Much in the way that loan loss reserves can mitigate credit risk, interest rate risk can be managed through use of interest rate hedges. And like loan loss reserves, these hedges involve costs that profit-maximizing banks are often not interested in bearing. The public bank can allocate some of its cost savings to purchase hedges, extend loan maturities, and meet the demand for patient capital. Other uses of the public bank's cost savings which are provided in the bill (Section 13) include taking subordinate positions (which also require higher risk reserves) and providing technical assistance grants to CDFIs.

D. The Public Bank Will Effectively Control Credit and Liquidity Risk

Current regulatory requirements will ensure the soundness of the public bank. Most basically the bank will be supervised by the Massachusetts Division of Banks, according to the same basic set of

⁹⁷ While costly, technical assistance provided by CDFIs dramatically reduces expected losses on loans. See Swack et al., [CDFI Industry Analysis: Summary Report](#) (2012), page 9, note 47.

⁹⁸ See Appendix, Table 5.

⁹⁹ Id.

¹⁰⁰ For reference, over the 2010s, national commercial banks had average loan loss reserves of around 1.68% of loans, while average charge-offs were 0.69% of loans, a proportion of about 1-to-2.5. See Appendix, Table 6.

¹⁰¹ Michael Swack and Public Banking MA, Massachusetts CDFI Credit Survey (2021).

¹⁰² In this context, interest rate risk refers to the risk that a bank with a fixed rate on its assets would face rising costs on its liabilities. As noted above (II.A), the cost of deposit funding (the main form of bank liability) is lower than other forms of debt finance, but banks can still face non-trivial cost increases in a rising interest rate environment. Like credit risk, interest rate risk is subject to prudential regulation.

rules that apply to other state banks.¹⁰³ The public bank will also be subject to federal regulation by the Boston Fed.¹⁰⁴

In speaking of the bank's soundness, it is common to distinguish between credit risk and liquidity risk. Credit risk concerns the risk that a bank's lending entails relative to the bank's capital (the excess of assets over liabilities) and its loan loss reserves. With a leverage ratio of 1- to-8, the public bank's capital position will be robust, and safer than the average private commercial bank.¹⁰⁵ Furthermore, savings on operating costs will allow the public bank to build additional loan loss reserves, above and beyond its capital. Data show that the business model of Massachusetts private banks precludes lending with virtually any credit risk, because their loan loss reserves are small so as to maximize profitability.¹⁰⁶ The public bank will be able to set aside additional loan loss reserves. Thus, it can engage in more inclusive lending practices responsibly.¹⁰⁷

Deposits in the public bank (\$1.4 billion) will also be extremely safe. A bank must deplete its capital and loan loss reserves before losses accrue to depositors. According to the law, regulators are responsible to close a bank long before losses accrue to depositors (here, the state in another hat), so any loss beyond a portion of the initial capital would require a considerable regulatory failure.¹⁰⁸ The possibility is therefore remote that the public bank would expose the commonwealth to loss on its deposits: its initial capital stands, loan loss reserves, and prudent leverage ratio all stand as a bulwark to such losses. We also note that even the full amount of bank deposits and capital represents a tiny fraction of the commonwealth's total liabilities (\$1.6 billion compared to \$104 billion).¹⁰⁹ This means that even if the exceedingly unlikely probability that the public bank lost that total, the amount at issue is far too small to impact the state's credit standing.

In sum, the probability of a loss is small, any loss itself would be relatively small, and the risk of loss should not be measured against unrealistic assumptions about current state balances, which themselves involve risk. Instead of focusing on remote hypotheticals, we encourage the Committee to look at a risk that is already material. That is the risk of shutting out a large portion of Massachusetts citizens from credit and opportunity.

¹⁰³ Section 3(g) of the bill subjects the public bank to regulation and examination by the Massachusetts Division of Banks ("the bank commissioner"). That provisions includes a number of small and highly technical modifications that would apply to the public bank relative to other state banks. These modifications do not change any of the key features of the regulatory framework.

¹⁰⁴ Section 3(c) of the bill authorizes the public bank to become a member of the Federal Reserve System, which, as a state bank, would subject the public bank to additional regulation by the Federal Reserve. See §§12 USC 324-5 (State Banks as Members). See also, CRS, [Who regulates Who?](#) An Overview of U.S. Financial Supervision (2010), page 33.

¹⁰⁵ The public bank's leverage ratio of 1-to-8 (12.5%) is meaningfully greater than private commercial banks average ratio of 1-to- 10 (10%). For the commercial bank data, see note 65 above. 2019 data was used to avoid accounting for temporary regulatory changes made during the COVID-19 crisis.

¹⁰⁶ See discussion in notes 89, 90 and references made there.

¹⁰⁷ See discussion in II.C.

¹⁰⁸ The legal rule, formally known as "prompt corrective action," formally applies to FDIC insured depository institutions (See 12 U.S. Code § 1831o), which covers virtually the entire field of US financial regulation. While the public bank will not be insured by the FDIC (see discussion below), there's little doubt the same regulatory approach would be taken by the Massachusetts Division of Banks and Boston Fed.

¹⁰⁹ See Commonwealth of Massachusetts, [Comprehensive Financial Report](#), p. 24 (total liabilities for total primary government).

As for liquidity risk, the public bank's design establishes effective management, ensuring its ability to meet its liabilities (deposits) as they fall due. As with credit risk, the public bank's framework for managing liquidity risk will be subject to standard regulation by the Massachusetts Division of Banks and the Boston Fed.¹¹⁰ The fact that the public bank will have a single depositor (or a single major depositor) does not present problems.¹¹¹ Mapping the logistics, which differ somewhat from that adopted by commercial banks, clarifies that point.

The deposit base of a commercial bank is typically broad and includes many depositors whose receipt of funds from other banks can be offset against deposit transfers to depositors in other banks. Deposit transfers require the payor's bank to transfer central bank reserves¹¹² to the bank of the payee. However, while payors in one bank are constantly calling on their banks to transfer reserves to the banks of payees, that bank is also taking in reserves as its other depositors are receiving payments from depositors in other banks. As a result of this reciprocity, a significant amount of bank credit in the form of deposit liabilities can be effectively offset between banks, allowing banks to hold an amount in reserves which is only a fraction of their deposits. That networked reciprocity is a key aspect of banks' ability to engage in maturity transformation (funding long-term assets with short-term liabilities).

Given its single depositor, the public bank will initially receive balances (\$1.4 billion) from the MMDT: the public bank's account at the Boston Fed will be credited with \$1.4 billion representing the same sum in deposit liabilities to the treasurer.¹¹³ As it is making loans to its borrowers (e.g., for a total of \$1.3 billion), the public bank will simply transfer reserves to the private banks holding those borrowers' accounts.¹¹⁴ This is entirely workable.

In turn, when the treasurer uses the public bank deposits to make transfers to payees in other banks, the public bank will transfer reserves to the private banks where those payees hold their accounts.¹¹⁵ Here, the same basic logic of networked reciprocity that works for private banks will hold for the public bank. While the treasurer will at times make payments (so the public bank will transfer out reserves), it will also be receiving payments from depositors in other banks (so the public bank will gain reserves). For example, taxpayers' payment to the commonwealth will be drawn on the wide array of private banks currently operating in the commonwealth. As the public bank presents these checks to the various banks, the public bank will be receiving reserves against the checks. Reserves will therefore remain networked; the state deposit base serves analogously to the customer base of a commercial bank.

¹¹⁰ See MA Division of Banks, [Regulatory Bulletin](#). Bank examinations (including by the Massachusetts Division of Banks) use a standardized system known as CAMELS. The "L" in the acronym stands for liquidity. For discussion of basic regulatory authority, see notes 93, 94.

¹¹¹ The legislation provides that, after the public bank is well-established and has been deemed by the state treasurer to have the requisite capacity, it could accept deposits of longer-maturity funds (over 180 days) from municipalities, quasi-publics, or the commonwealth. See Section 9(e).

¹¹² Central bank reserves are balances commercial banks hold in accounts with their regional Federal Reserve bank (e.g., the Boston Fed) to manage their liquidity. They are not to be confused with "loan loss reserves" (see discussion in II.C above) that protect a bank's capital.

¹¹³ In balance sheet terms, +\$1.4 billion reserves (Assets); +\$1.4 deposits to Massachusetts treasurer (Liabilities). For simplicity, we are abstracting from the additional \$200 million transfer to be made for the bank's capital. In balance sheet terms, that transaction would involve +\$200 million in reserves (Assets); +\$200 million in shareholders' equity (held by Massachusetts).

¹¹⁴ In balance sheet terms, +\$1.3 billion loans (Assets); -\$1.3 billion reserves (assets).

¹¹⁵ In balance sheet terms, -reserves (assets); -deposits to Massachusetts treasurer (liabilities).

The business of the commonwealth will produce some differences in pacing; those differences do not affect the offsetting logic. For example, some payments to the treasurer (e.g., income taxes) may be concentrated around particular dates while the treasurer will have to meet payment demands at other times. Like all banks facing temporary mismatches in their liquidity, the public bank will have tools designed for the problem. First, like all banks, the public bank will hold a portion of its assets as a liquidity buffer (reserves and securities) to handle relatively short-term fluctuations.¹¹⁶ Second, like all banks, the public bank will have access to short-term interbank markets where it can lend excess liquidity, and borrow in times of a liquidity deficit. Third, like all banks, the public bank will have access to the Federal Reserve's discount window (Federal Reserve Act, Sec. 10B.) where banks facing a liquidity shortage can borrow against a broad range of collateral (including commercial loans).¹¹⁷

For over a century, the Bank of North Dakota, whose deposit base also consists of public deposits, has proved liquidity management under this model can work successfully.¹¹⁸ Indeed, under the proposed legislation, liquidity management by the Massachusetts public bank will be simpler than BND's, and in certain respects, even simpler than private banks. Most importantly, the public bank will not handle any of the state's "fast money" which is used in daily transactions (payroll, transfer payments etc.). Fast money is currently held in commercial banks with specialized staff and IT infrastructure to handle a large number of transactions. Instead, the funds targeted for the public bank are "slow money" that are set aside from funds used for daily transactional purposes.¹¹⁹ As above, the commonwealth has upwards of \$20 billion located in the MMDT; even in the most recessionary times, that money will be available before the commonwealth need contemplate using public bank deposits.¹²⁰ In other words, the funds to be handled by the Massachusetts public bank are the very slowest tranche of the slow money. In distinction, the BND handles all North Dakota's deposits, including its fast money.¹²¹ If the BND can successfully manage the fast money, the Massachusetts public bank's task is surely possible.

In sum, the public bank will have a sound liquidity management framework, one subject to standard banking regulation. Although operating with a single deposit base presents slightly different logistics, the same logic of networked reciprocity of deposits holds for the public bank as for commercial banks. In turn, the temporary liquidity mismatches that all banks encounter will be handled by the standard tools, a combination of liquidity buffers and interbank borrowing, backstopped by the Fed's discount window. Finally, the BND's practice for over a century is a proof

¹¹⁶ As mentioned in note 84, private Massachusetts banks had a slightly higher deployment ratio than BND (69% to 58%). This represents an additional margin of liquidity for MDT. This is a difference of degree rather than a difference in kind. As noted below, the additional liquidity is likely attributed to BND's need to handle "fast money" which is not relevant for the Massachusetts public bank.

¹¹⁷ Indeed, public bank borrowing in interbank markets would be simpler than it is for most banks given the Massachusetts state guarantee (Section 10 of the bill).

¹¹⁸ See [BND's 2019 Annual Report](#). "BND's primary deposit products are interest-bearing accounts for state and political subdivisions". The BND's deposit base is slightly broader insofar as it includes deposits by local government. However, these deposits add relatively little diversity (e.g., subject to similar tax calendars) and should not change the thrust of the analysis. (For the option of municipal deposits by the Massachusetts public bank, see note 101).

¹¹⁹ See Section 9(b).

¹²⁰ See discussion in II.A, note 48.

¹²¹ See North Dakota Century Code, 6-09-07 ("All state funds and funds of all state penal, educational, and industrial institutions must be deposited in the Bank of North Dakota by the persons having control of such funds or must be deposited in accordance with constitutional and statutory provisions.").

of concept. Indeed, special features in the bill – specifically, limiting deposits to a fraction of slow money – will make liquidity management by the Massachusetts public bank simpler and more particularly reliable.

E. The Public Bank Is an Affordable Project for the Commonwealth

There are two costs associated with the capital (\$200 million) and deposit transfer (\$1.4 billion) that will fund the bank; both are minimal. Using recent municipal bond yields as a measure of borrowing costs, funding the initial \$200 million capital investment will amount to around \$3 million a year.¹²² Second, there is the opportunity cost in forgone interest on the \$1.4 billion currently held in the MMDT. Using the 2013-2022 average MMDT yield of 1%, revenues could decline by around \$14 million ($=1\% \times \1.4 billion).¹²³ Before any offsets are calculated (see below), the total estimate for reduction in fund balances at the end of the year is therefore \$17 million. That amount is only 0.02% of the commonwealth's \$81.2 billion in total annual revenue.¹²⁴

The modest fiscal cost of the bill will be recouped, and likely considerably exceeded through its increase of economic activity in the state, and consequently, an increase in the tax base. By supporting sustainable credit to underserved communities, the public bank will create new jobs and sales. These jobs and sales are taxable at a rate of 5% (individual income) and 6.25% (sales taxes).

An increase of only \$340 million in taxable economic activity will suffice to cover the \$17 million cost ($=\$17 \text{ million} / 5\% \text{ tax rate}$). With public bank assets of \$1.6 billion, and over \$1 billion in lending, achieving this breakeven amount is a high probability.

While a formal projection of the fiscal impact is beyond our current scope, simple calculations will help inform such future analysis. The record of mission lenders elsewhere suggests the likelihood of full recoupment of cost by documenting the quantitative relationship between amounts lent and economic development created. Opportunity Finance Network, a national CDFI association, reports that since its inception, its members created or retained 1.75 million jobs while providing about \$83 billion in cumulative finance, reflecting an average lending outlay per job of about \$47,500 ($=\$83 \text{ billion} / 1.75 \text{ million jobs}$).¹²⁵ Using the same ratio, with over \$1 billion in lending, the public bank would create or help retain about 21,000 jobs ($= \$1 \text{ billion} / \$47,500$). Using the conservative assumption that all jobs involved are low-income jobs at \$40,000 annually, these jobs will generate a total of nearly \$840 million in wages per year. That amount would flow from increased production and sales by businesses providing employees with new consumption power and generating further sales and income from their spending. Tax benefits to low-income earners (like the Earned Income Tax Credit) make the income tax from initial wage creation somewhat complex to forecast. At the same time, we believe that using standard economic impact analysis (including multipliers) will demonstrate that the \$840 million increase in wages, and its various ripple effects on income and sales, would generate an increase in state revenue far in excess of the \$17 million cost described above (that is, it will increase the tax base by at least \$340 million

¹²² This figure represents October 2021 yields of around 1.45% on 20-year municipal bonds with AA rating (accessed through [FMS bond Inc.](#)). According to our projections (II.C above), the return on equity on the commonwealth's shares in the public bank would considerably exceed this cost of borrowing, but we are assuming the public bank will retain its net income for expansion and building up of additional loss reserves.

¹²³ See discussion in II.C.

¹²⁴ See [2022 MA Comprehensive Annual Financial Report](#), page 46.

¹²⁵ OFN, [Side by Side](#) (2019), page 6

in taxable income and sales). Such economic impact analysis will demonstrate that the small cost of the bill will be more than fully recouped by the commonwealth in the form of increased taxation capacity.

F. The Public Bank's Governance Structure Ensures Accountability

The public bank's proposed governance ensures inclusive participation in its decision making and rigorous accountability for its operations. The decision makers who will direct the operations of the bank will be populated by representatives of the very same collaborators and beneficiaries the bank is intended to support and by experts who can ensure the bank is lending in line with its goals. This comprehensive feedback loop is embedded throughout the governance structure of the bank.

The bank's board of directors ensures this representative control: it will be made up of the state treasurer and eight others who will represent CDFIs, local banks, credit unions and co-ops, small businesses, public finance and economic development, and environmentally-conscious financing.¹²⁶ Furthermore, this board will reflect the geographical, racial and gender diversity of the state including rural, urban & suburban areas.¹²⁷ The board, made up of the bank's intended recipients, will appoint the CEO, who will serve at the pleasure of the board.¹²⁸ In this way, the day-to-day management of the bank will have rigorous oversight by the representative board.

The bank's 18-member board of advisors will be representative of the bank's intended recipients, and will include organizations representing small businesses, co-ops & worker-owned enterprises, underserved neighborhoods, sustainable agriculture, climate change concerns, environmental justice, municipalities, workers including low-income workers, local banks and credit unions in addition to the Lieutenant Governor and the Boston Fed's director of community development.¹²⁹ The board of advisors will meet regularly and will be responsive to public input.

The bill provides robust opportunities for public comment in the form of an internet-based comments portal, created by the Board of Advisors, for the public to share their concerns regarding their need for loans. The Board of Directors, CEO and staff will all have direct access to the public comments to ensure that the public's voice is heeded, and the Board of Advisors will address the public's concerns via the comments portal at its quarterly meetings.¹³⁰ The Board of Advisors will also directly represent a broad array of public concerns and will address concerns raised by the public on the comments portal and at annual joint meetings with the Board of Directors.

Lastly, the legislation imposes additional safeguards on the public bank. The bank has extensive reporting requirements to the state treasurer, including on its ability to provide affordable financing, the number of recipients, amounts and forms of financing provided, the record of the public bank's adherence to statutory priorities, and compensation practices. Those reports will be backed by the transaction records required to be maintained by bank officials. Financial reports subject to outside audit are due annually on the bank from the state treasurer.¹³¹

¹²⁶ See Section 4(a).

¹²⁷ See Section 4(b).

¹²⁸ See Section 4(g).

¹²⁹ See Section 7(a).

¹³⁰ See Section 7(b).

¹³¹ See Section 11.

III. The Public Bank Will Complement and Strengthen Other Lenders in Massachusetts

A. The Public Bank Will Work with Private Banks, Credit Unions, and CDFIs

The creation of this public bank will not take business from any existing banks, CDCs, or CDFIs. The public bank won't have branches or ATMs. It won't be competing with commercial banks for deposits and or any services.¹³² Under the bill, it will be prohibited from taking deposits from people, businesses, or even treasurer deposits held in private banks (its only deposits will come from a small portion of MMDT balances).¹³³ On the lending side, by its very design, the loans the public bank will hold are ones commercial banks are not interested in underwriting: Commercial banks' business models, as described above, make it unsustainable for them to invest in identifying and offering the loans that the public bank will prioritize. Instead, the public bank will work alongside the existing financial infrastructure in Massachusetts to help meet currently unmet credit needs.

The small size of the public bank reinforces its noncompetitive role as collaborator: it will only have assets of around \$1.6 billion compared to commercial banking's \$350 billion.¹³⁴ The bill directs the Bank to collaborate with private Massachusetts banks and CDFIs. The proposed legislation instructs that "[w]hen appropriate, the Bank's provision of lending and de-risking under Section 13(a) shall be conducted through participation lending programs, with Massachusetts banks and community development institutions originating and servicing the loans."¹³⁵ The bill continues, "[t]he Bank shall partner rather than compete with those entities to strengthen them and to expand affordable financing in the commonwealth."¹³⁶ These participation loans allow local banks to benefit from origination fees and from being able to work with a lender to make a larger loan—without the threat of being taken over by a larger bank. Similarly, the legislation ensures that the bank can work in tandem with Massachusetts' important state agencies promoting affordable housing and local development like MassDevelopment and Mass Capital Growth Corporation, in order to increase their reach.

B. The Public Bank's Activities Have No Considerable Overlap with Existing Credit Programs

Although Massachusetts has several credit programs, there is no considerable overlap between these programs and the public bank. In some instances, the public bank will address credit needs that are distinct from those of the existing programs. In other instances, the public bank's mission is more similar to an existing program, but that program is extremely limited in its scope. In such instances, the bill (Sections 12 and 14) authorizes and even prioritizes public bank collaboration with quasi-public entities to bolster their capacity. In our view, the strongest testimony about the need for a collaborative approach comes from community development practitioners with decades

¹³² See Sections 3(a), 9

¹³³ See II.A. The bill allows the public bank to accept deposits from municipalities under certain conditions, including that they will be longer-term deposits. Such longer-term municipal balances are currently kept in MMDT and will not be in competition with commercial banks.

¹³⁴ See Federal Reserve Bank of St. Louis, [Total Assets for Commercial Banks in Massachusetts](#).

¹³⁵ Section 14(h). A "participation loan" is defined as "a loan in which the Bank shares in funding or overseeing an advance of credit under a written agreement between the originator of the loan and the Bank." Section 2.

¹³⁶ Section 14(g) (emphasis added).

of experience in the commonwealth. We note especially the written testimony of Mr. Bob Van Meter (submitted 2021), former chief executive of LISC, a CDFI:

“There are other institutions and players and it is also true that access to capital is not the only challenge facing small business, but the Public Bank will meet needs that Mass Growth Capital and other small business lenders are not able to meet alone. It will collaborate with other lenders by participating in loans and providing lower interest funds that can bring down the total cost to the borrower.”

In this section we provide further detail by briefly surveying two existing programs: Mass Development and Mass Growth. Our figures use 2022 annual financial and OPMO reports and (the most recently available).¹³⁷

1. Mass Development

Mass Development provides loans and guarantees to facilitate economic development and industrial growth in the commonwealth. During 2022, typical borrowers and guarantee recipients included charter schools, emerging technology companies, and community services (health, elderly services) seeking real-estate finance.

- The scale of lending and guarantees by Mass Development is small compared to the public bank, which is designed to have lending capacity of around \$1.3 billion.¹³⁸ While Mass Development’s balance sheet appears large at first sight – \$548 million – its loan portfolio is much smaller, about \$102 million, with only \$91 million providing long-term credit. Total guarantees outstanding are difficult to decipher from the annual report, but appear to be comparable to or smaller than the loan portfolio.¹³⁹
- Mass Development’s activities as a commercial lender are especially small whereas commercial lending will be an important business line for the public bank (through collaboration with CDFIs and community banks). During 2022, Mass Development provided approximately \$9 million in commercial loans and guarantees (out of a total of \$58 million).¹⁴⁰
- Mass Development does not provide substantial technical assistance to private borrowers, whereas the public bank will facilitate technical assistance on a large scale through its support of CDFIs. During 2022, Mass Development’s technical assistance was under \$1 million, and provided almost exclusively to cities.¹⁴¹

In sum, there is no considerable overlap between Mass Development’s activities and the public bank. Mass Development does not collaborate with CDFIs, its involvement in commercial lending is relatively small, and its overall lending is on a considerably smaller scale.

¹³⁷ The Office of Performance Management and Oversight (OPMO) provides annual reports on the performance of quasi-public entities engaged in economic development. The 2022 report is available [here](#).

¹³⁸ See II.A.

¹³⁹ See Massachusetts Development Finance Agency, [Financial Statements \(FY 2022\)](#), page 19 (the loan figure is the sum of loans receivable (current and noncurrent), and the small business recovery loan fund). The relative volume of guarantees to loan activity is estimated based on the OPMO FY2022 MassDevelopment Report Attachment available [here](#) (“Loans & Guarantees” tab).

¹⁴⁰ See Mass Dev, [OPMO FY2022 MassDevelopment Report Attachment](#) (“Loans & Guarantees” tab).

¹⁴¹ See Mass Dev, [OPMO FY2022 MassDevelopment Report Attachment](#) (“Technical Assistance” tab).

2. Mass Growth Capital Corporation

Mass Growth provides debt financing for small businesses, and focuses its activities on minorities, females, veterans and underserved communities. It offers technical assistance to borrowers (about \$21 million during 2022) in ways that resemble the CDFIs that will be one of the main recipients of public bank support.¹⁴²

Although Mass Growth's mission is similar to the public bank, the scale of Mass Growth's operations is comparatively small. Its net loans receivable for 2022 was only \$4 million, with about \$2.5 million being long-term (total assets were \$97 million).¹⁴³ Due to legal restrictions, Mass Growth is very limited in its ability to borrow to fund its activities, and must therefore rely on appropriations.¹⁴⁴ For this reason, the public bank's ability to collaborate with Mass Growth through loan participations could considerably increase Mass Growth's capacity.

C. The Current Legislation Is Distinct From An Earlier Proposal And Should Be Considered Anew

In 2011, a special commission considered a public banking proposal in response to the 2008 financial crisis and recommended against the proposal in its final report.¹⁴⁵ The 2011 proposal was unlike this proposal in three fundamental ways: the purpose of the institution, the size of the institution, and the institution's cash management system. Because the two proposals differ in such important areas, the investigation into the 2011 proposal does not functionally apply to the current legislation and requires consideration with entirely fresh eyes.

In the aftermath of the 2007-9 financial crisis, the main purpose cited under the 2011 initiative involved macro stabilization of the state's economy.¹⁴⁶ Conversely, a key goal of the present legislation is to expand affordable financing in underserved communities, especially through cooperation with Community Development Financial Institutions (CDFIs) and other intermediaries. That goal has no mention in the 2011 Commission Report. In rejecting the 2011 bill, the Committee Report cited a study by the Boston Fed finding the Bank of North Dakota (the only public bank operating in the U.S.) did not in fact contribute to macroeconomic stabilization of the state's economy. What was then cited as a reason for rejection has no bearing on the current bill.¹⁴⁷

Furthermore, this legislation proposes a much smaller public bank than previously considered: only \$200 million in capitalization, and \$1.6 billion in assets, compared to a \$30 billion bank (with \$3.6 billion in capitalization) contemplated in the 2011 study.¹⁴⁸ Indeed, the 2011 Commission Report cited the large cost of capitalizing the public bank as one of the main considerations in objecting to the bill.¹⁴⁹ In contrast, the smaller size of the public bank in this 2021

¹⁴² See OPMO FY2022 MGCC Report Attachment [available here](#) ("Technical Assistance" tab).

¹⁴³ Massachusetts Growth Capital Corporation, [Financial Statements](#) (FY 2022), pages 8, 20

¹⁴⁴ [M.G.L. Ch. 40W, § 3\(i\)](#).

¹⁴⁵ See the [2011 Commission report](#).

¹⁴⁶ *Id.*, pages 7–8.

¹⁴⁷ *Id.*, pages 3, 7.

¹⁴⁸ *Id.*, page 9.

¹⁴⁹ *Id.*, page 3. The capitalization figure mentioned in the report is \$3.6 billion and was scaled based on historical figures for the Bank of North Dakota. Assuming a 1-to-10 leverage ratio, such a bank would have had approximately \$36 billion

legislation is a function of the difference in goals. This bill is not designed to stabilize the state economy, but rather to address the unmet credit needs of underserved communities. The public bank contemplated in this bill is scaled to meaningfully contribute to those needs. Given its small size, it is not expected to affect the commonwealth's finances.¹⁵⁰

Lastly, this legislation proposes a structure with far fewer logistical hurdles for managing the state treasurer's deposits than the 2011 initiative. The public bank described in this bill will hold only \$1.4 billion in deposits, which is a small fraction of total funds managed by the treasurer.¹⁵¹ Even more importantly, those funds will not be transferred from commercial banks where the treasurer maintains deposits requiring complex operations (payroll, taxes, etc.), also known as "fast money." The 2011 Commission Report was concerned that recreating such operations at the level of a public bank would be complex and costly.¹⁵² Instead, the \$1.4 billion of public bank deposits under the 2021 legislation will be transferred from the Massachusetts Municipal Depository Trust (MMDT), a prime money market fund handling "slow money" that does not involve operational complexity.¹⁵³ This operational simplification saves on cost and complexity compared to previous iterations.¹⁵⁴

Conclusion

Despite the strength of the Massachusetts economy for some, we are long overdue for structural reform that enables the commonwealth to fulfill the unmet financial needs of our communities. The public bank will help our state become more resilient in the face of economic downturns and climate impacts and will help the state address unmet financing needs of communities of color, women, small businesses, and farmers in cooperation with our state agencies, local banks and CDFIs. Public funds should work for the public—always. By providing a safe depository and a development-oriented lending operation owned by the commonwealth, the Bank will empower the citizens of Massachusetts to harness the power of modern finance in support of their own economic well-being. We urge you to favorably report An Act to Establish a Massachusetts Public Bank. Thank you for your time and consideration.

Respectfully submitted,

MASSACHUSETTS PUBLIC BANKING

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in assets, making it one of the largest banks in the commonwealth. The fear of industry opposition to such a large bank was another consideration the 2011 report gave in rejecting the plan.

¹⁵⁰ See II.E for further detail.

¹⁵¹ See notes 39-40 above.

¹⁵² See the [2011 Commission report](#), page 9.

¹⁵³ See II.A, II.E for further detail.

¹⁵⁴ Note that given the large size of the public bank anticipated in the 2011 discussions, all of the treasurer's balances at the time (and many billions more) would have had to be transferred to that public bank.

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Appendix

Table 1: Private Massachusetts Banks' Operational Efficiency

	Average	MA Banks '19 (% of assets)	MA Banks 17 (% of assets)	MA Banks '15 (% of assets)	MA Banks '13 (% of assets)	MA Banks '11 (% of assets)
A.1. Efficiency ratio (from peer report)	73.4%	72.4%	72.1%	75.0%	75.8%	71.8%
A.2. Efficiency ratio (=B/C)	76.8%	76.7%	73.8%	77.2%	78.3%	77.9%
B. Non-interest expense	2.8%	2.6%	2.7%	2.8%	2.8%	3.0%
C. Operating income (=Sum C)	3.6%	3.4%	3.7%	3.6%	3.6%	3.9%
C.1. Net interest income	3.0%	2.9%	3.1%	3.0%	3.0%	3.2%
C.2. Non-interest income	0.6%	0.6%	0.6%	0.6%	0.7%	0.8%
C.3. Provision for loan loss	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%

Source: Data from peer group average report can be accessed on [FFIEC's website](#) (MACOM—All Insured Commercial Banks in Massachusetts, 12/31/19; 12/31/17; 12/31/15; 12/31/13; 12/31/11).

We have compared our internally calculated efficiency ratio (row A.2.) to the official ratio in the group report (row A.1.). The small difference between the two is likely attributable to small items not included in our spreadsheet (like amortization of non-tangible assets). The efficiency ratios included in the testimony are the official ones (which are slightly lower, and hence, more conservative in estimating the difference with BND). The equivalent items were also not included in the BND figures below (Appendix Table 2).

Table 2: Bank of North Dakota Operational Efficiency

	Average	BND '19 (thousands)	BND '19 (%) of assets	BND'17 (thousands)	BND' 17 (%) of assets	BND '15 (thousands)	BND '15 (%) of assets	BND '13 (thousands)	BND '13 (%) of assets	BND '11 (thousands)	BND '11 (%) of assets
A. Efficiency Ratio (=B/C)	20.9%	18.0%	18.0%	17.5%	21.3%	17.0%	16.7%	27.7%	27.9%	23.4%	22.9%
B. Non-interest expense (operating cost)	0.45%	\$37,090	0.5%	\$30,886	0.4%	\$26,668	0.4%	\$36,172	0.5%	\$21,494	0.4%
C. Operating income (=Sum C)	2.14%	\$206,139	2.9%	\$176,170	2.1%	\$ 157,322	2.1%	\$ 130,387	1.9%	\$91,829	1.7%
C.1. Net interest income	2.25%	\$205,223	2.9%	\$181,835	2.6%	\$162,134	2.2%	\$ 122,965	1.8%	\$97,918	1.8%
C.2. Non-interest income	0.10%	\$6,916	0.1%	\$6,335	0.1%	\$7,688	0.1%	\$ 7,422	0.1%	\$4,911	0.1%
C.3. Provision for loan loss	0.13%	\$6,000	0.1%	\$12,000	0.2%	\$ 12,500	0.2%	0	0.0%	\$11,000	0.2%
D. Assets		\$7,058,432	1	\$7,003,302	1	\$7,407,942	1	\$6,873,409	1	\$5,375,073	1

Source: Data from the Bank of North Dakota's annual reports, available [on its website](#).

Table 3: North Dakota Banks Operating Efficiency

	Average	ND Banks '19 (% of assets)	ND Banks '17 (% of assets)	ND Banks '15 (% of assets)	ND Banks '13 (% of assets)	ND Banks '11 (% of assets)
A.1. Efficiency ratio (peer report)	62.9%	62.4%	63.4%	61.5%	63.2%	64.2%
A.2. Efficiency ratio (B/C)	64.6%	64.5%	64.4%	62.5%	64.0%	67.6%
B. Non-interest expense	2.6%	2.7%	2.6%	2.6%	2.5%	2.7%
C. Operating income	4.0%	4.1%	4.1%	4.1%	3.9%	4.0%
C.1. Net interest income	3.7%	3.8%	3.7%	3.7%	3.5%	3.7%
C.2. Non-interest income	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%
C.3. Provision for loan loss	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%

Source: Data from peer group average report can be accessed on [FFIEC's website](#) (NDCOM—All Insured Commercial Banks in North Dakota, 12/31/19; 12/31/17; 12/31/15; 12/31/13; 12/31/11). We have compared our internally calculated efficiency ratio (row A.2.) to the official ratio in the group report (row A.1.). The small difference between the two is likely attributable to small items not included in our spreadsheet (like amortization of non-tangible assets). The efficiency ratios included in the testimony are the official ones. The equivalent items were also not included in the BND figures below (Appendix Table 2).

Table 4: Deployment Ratios by Private MA Banks and the Bank of North Dakota

	Average	2019	2017	2015	2013	2011
MA banks Net loans and leases (% of assets)	69.6%	73.9%	74.0%	72.0%	65.3%	62.6%
BND assets (thousands)	\$ 6,743,632	\$ 7,058,432	\$7,003,302	\$7,407,942	\$6,873,409	\$5,375,073
BND Loans net of allowance (thousands)	\$ 3,980,869	\$ 4,442,253	\$ 4,824,320	\$ 4,270,324	\$ 3,425,176	\$ 2,942,271
BND Loans net of allowance (% of assets)	58.8%	62.9%	68.9%	57.6%	49.8%	54.7%

Source: Data for private MA banks is from the peer group average report, and can be accessed on [FFIEC's website](#) (MACOM—All Insured Commercial Banks in Massachusetts, 12/31/19; 12/31/17; 12/31/15; 12/31/13; 12/31/11). Data for BND from its financial statements for the same years, which can be accessed on its [website](#).

Table 5: Loan Loss Reserve (as Percentage of Loans and Leases) for MA and National Banks

	Average	2019	2017	2015	2013	2011
LN&LS allowance to total LN&LS	0.95%	0.82%	0.86%	0.91%	1.02%	1.12%
National banks LN&LS	1.44%	1.23%	1.24%	1.34%	1.57%	1.80%

Source: Data from peer group average report can be accessed on [FFIEC's website](#) (MACOM—All Insured Commercial Banks in Massachusetts, NATIONAL— All Banks in Nation, 12/31/19; 12/31/17; 12/31/15; 12/31/13; 12/31/11).

Table 6: Charge-Off Rates and Loans Loss Reserve for National Commercial Banks (2011-19)

	Charge-Off Rate on All Loans, All Commercial Banks (%)	Loan Loss Reserve to Total Loans for all U.S. Banks (%)
2011	1.63	2.91
2012	1.12	2.37
2013	0.69	1.92
2014	0.49	1.58
2015	0.42	1.39
2016	0.46	1.32
2017	0.47	1.27
2018	0.46	1.22
2019	0.49	1.18
Average	0.69	1.68

Source: Data from FRED, [Charge-Off Rate on All Loans](#), All Commercial Banks; [Loan Loss Reserve](#) to Total Loans for all U.S. Banks.