

Date of Hearing: April 15, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 2062 (Grayson) – As Amended April 1, 2024

SUBJECT: Credit unions

SUMMARY: Makes assorted changes to California Credit Union Law (Credit Union Law), including changes related to membership applications, governance structures, sale of credit union assets, and virtual member meetings.

Specifically, **this bill:**

- 1) Specifies that a credit union’s “savings capital” consists of payments made by members on shares, and makes corresponding changes to references to “savings capital” in the Credit Union Law.
- 2) Allows a credit union to use an automated system to establish membership eligibility if specified conditions are met.
- 3) Authorizes a board of directors to, by resolution, delegate its authority to declare dividends or set dividend rates to an asset-liability management committee consisting of directors, non-director management officials, or both.
- 4) Authorizes a credit union to invest in a credit union services organization (CUSO) where the CUSO is formed by one or more credit unions and one or more CUSOs, or any combination thereof.
- 5) Makes the following changes to provisions prohibiting an officer, director, or employee from purchasing any credit union asset for less than the then-market value:
 - (a) Specifies that the method used to determine market value shall be the average of the value of the asset as determined by no less than three independent sources recognized in the industry for establishing market value with a private-party purchase and sale of comparable assets.
 - (b) Exempts from the prohibition any used equipment or furnishings that do not exceed \$500 in the aggregate
- 6) Allows the annual credit union member meetings to elect directors, a supervisory committee, and a credit meeting, as well as any special meeting held upon the order of the board, to be conducted virtually, as long as specified steps are taken related to participation and vote verification.

EXISTING LAW:

Credit Union Law

- 1) Provides for the California Credit Union Law (Financial Code Section 14000 et. seq.), administered by the Department of Financial Protection and Innovation (DFPI), which

prescribes the rules applicable to any person, other than a federal credit union, that engages in business as a credit union in this state. (Financial Code Section 14001.1)

- 2) Authorizes DFPI to investigate the affairs and examine the books, accounts, records, files, and any office within or outside this state that is used in the business of a credit union, and provides that an examination made by the commissioner in conjunction with or with assistance from the National Credit Union Administration (NCUA) or a credit union regulatory agency of another state is deemed to be an examination made by the commissioner. (Financial Code Section 14250)
- 3) Authorizes a credit union to admit to membership a person qualified for membership upon either the purchase of a membership or one or more shares as provided by the credit union's bylaws or the payment of an entrance fee established by the board of directors. (Financial Code Section 14800)
- 4) Provides the board of directors with the duty to act upon all applications for membership and authorizes directors to delegate the power to approve applications to a membership committee or an executive committee or to an officer, director, committee member, or employee. (Financial Code Section 14456)
- 5) Provides the board of directors with the duty to determine from time to time the interest rate on obligations with members and to authorize the payment of interest refunds to borrowing member and declare dividends on shares in accordance with the credit union's policies and to determine the interest rate or rates that will be paid on certificates for funds. (Financial Code Section 14456)
- 6) Authorizes a credit union to invest in the shares of stock of a corporation, or in membership or economic interests of a limited liability company, organized solely for the purpose of providing services to credit unions, provided the corporation or limited liability company is formed by a credit union or group of credit unions. (Financial Code Section 14651)
- 7) Prohibits an officer, director, or employee of a credit union from purchasing, directly or indirectly, or being interested in purchasing, any of the credit union's assets for an amount less than the current market value or any of the credit union's obligations for an amount less than the book value. (Financial Code Sections 14765 and 14766)
- 8) Requires members of a credit union to hold an annual member meeting for the election of directors, a supervisory committee, and a credit committee, and authorizes a special meeting of the members upon order of the board of directors. (Financial Code Sections 14766 and 148004)

Nonprofit Corporation Law

- 1) Authorizes a board to create one or more committees, consisting of two or more board directors, to have the authority of the board, except with respect to specified duties such as compensation setting and filling board vacancies.

- 2) Allows a nonprofit mutual benefit corporation to conduct a meeting of its members, in whole or in part, by electronic transmission by and to the corporation, under specified conditions. (Corporations Code Section 7510)

FISCAL EFFECT: Unknown. This bill is keyed fiscal by Legislative Counsel.

COMMENTS:

- 1) **Purpose.**

According to the author:

The California Credit Union League champions a “state-charter modernization bill” every few years to promote governance and management efficiencies and to keep state-chartered credit unions on an even playing field with both federally chartered credit unions. Between modernization clean up bills, the League compiles a list of issues brought to them by their members. AB 2062 is the culmination of many discussions between state-chartered credit unions, their league, and other stakeholders

- 2) **How does a credit union work?**

A credit union is a not-for-profit cooperative that accepts deposits, makes loans, and offers a variety of financial services and products to its members. Under state law, a credit union is formed for the purposes of “creating a source of credit for [members] at rates of interest set by the board of directors, and providing an opportunity for them to use and control their own money on a democratic basis in order to improve their economic and social condition.”

In many important ways, a credit union functions similarly as a bank and is subject to comparable rules and requirements designed to ensure the safety and soundness of the institution. But, as a cooperative corporation, a credit union is organized and managed much differently than a traditional bank. For example, a credit union is subject to a “field of membership” requirement, meaning that its membership must be limited to groups with a “common bond.” This common bond requirement is the reason a credit union may consist of members of a church or labor union, employees of one company, or residents of a defined geographic area.

A credit union also has unique governance because of its nonprofit cooperative structure. A credit union’s unpaid board of directors is elected by the credit union’s members, who each have a vote regardless of how much money they have held at the credit union. State law also establishes duties and roles for committees and leadership, including the credit committee and the audit committee.

- 3) **How is a credit union regulated?**

A credit union, like a bank, operates under a dual licensing framework and is chartered (or licensed) by the state or by the federal government. The type of charter determines which agency supervises the credit union, with the National Credit Union Administration (NCUA) regulating federally-chartered credit unions and DFPI regulating state-chartered credit

unions. California's state charter provides similar authorities, requirements, and characteristics as the federal charter, and as of March 1, 2024, there were 112 state-chartered credit unions operating in California.

At first glance, it is unclear whether there are any direct societal benefits from a dual-charter system. After all, much of the oversight of financial institutions like banks and credit unions occurs at the federal level. The addition of state regulators seems like adding more cooks to a kitchen filled with a mix of regulators with different purviews, interests, and expertise.

However, regulators and industry argue the dual-charter system works well for both consumers and industry. The availability of a state charter or both banks and credit unions is believed to produce real and tangible benefits by making the federal and state governments "compete" for financial institutions. For example, DFPI's website cites a number of advantages for financial institutions that obtain a California charter. Among the benefits are lower fees and assessments, minimal intrusion of examiners into institutions that are well-managed and well-capitalized, and more direct and timelier contact with the regulator. DFPI states that the "combination of access, low fees, favorable state laws, and expertise and experience of the Department's staff, make the state charter the charter of choice for California financial institutions."¹

4) Major provisions

As noted above, this bill makes a variety of modifications to California's state credit union charter. These changes are meant to update current law to reflect modern industry practices or to achieve more efficiencies. In sum, these changes aim to make the state credit union charter more attractive. Proposed changes include:

- a) **Reinserting the definition of "savings capital" into the Law.** Prior to 2019, the Credit Union Law required a credit union's board of directors to establish a written savings capital structure policy to set out the terms and conditions upon which credit union shares may be issued, transferred, or withdrawn, with the goal of avoiding instability in the credit union's savings capital and ensuring that the credit union has adequate source of funds for loans. However, these requirements predated the enactment of new federal regulations, including Federal Regulation CC, Regulation DD, and 12 CFR Part 707. These regulations, taken together, made California's savings capital structure rules obsolete. In response, AB 2862 (Limón), Chapter 267, Statutes of 2018, a CCUL-sponsored charter clean-up bill, deleted those requirements.

AB 2062 reinserts a definition of "savings capital" because the Credit Union Law still includes a number of references to the original concept.

- b) **Clarifying that a board can delegate certain authorities to an asset-liability management committee (ALCO) consisting of non-directors.** Credit Union Law and the Nonprofit Corporation Law, which applies to credit unions, establish the ways a credit union's board can delegate certain authorities and duties to committees. For example, under Nonprofit Corporation Law, a board may delegate certain duties to a

¹ "Advantages of a State Charter," DFPI (Updated September 2019), available at: <https://dfpi.ca.gov/advantages-of-state-charter/>

committee that exercises the authority of the board, so long as that committee consists exclusively of directors. AB 2062 allows a state-chartered credit union to delegate the authority to declare dividends to an ALCO consisting of both directors and non-directors, which the sponsor argues is a reasonable delegation that aligns California's law with the Illinois chartering law.

- c) **Clarifying investments in credit union service organizations (CUSOs).** A CUSO is an entity owned, in whole or in part, by a single or a group of credit unions and primarily serves a credit union. A CUSO generally is allowed to perform only permitted services, such as checking and currency services, clerical services, credit card loan origination services, and payroll processing. According to the National Credit Union Service Organizations (NACUSO), shifts in the marketplace have made CUSOs more common because they help credit unions save operational costs and add alternative income streams. The Credit Union Law currently allows a credit union to invest in a CUSO that is formed by a credit union or a group of credit unions. AB 2062 adds a formal definition for a CUSO, which does not currently exist, and clarifies that a credit union may invest in a CUSO that is formed by one or more credit unions and another CUSO.
- d) **Modifying the rules around the sale of credit union assets.** The Credit Union Law imposes a strict penalty on any credit union officer, director, or employee that buys a credit union asset for "less than the then-current market value" or purchases a credit union's obligations for "less than the book value." Upon a violation, the person is liable in the amount of twice the market value of the assets purchased.

The purpose behind this prohibition is presumably to prevent insider abuse, but CCUL argues its application is impractical and overly broad. CCUL points to a number of challenges:

First, there are no definitions of market value and book values, which creates ambiguity in whether a transaction is actually a violation.

Second, there is no de minimis exemption, which raises concerns about gifts or small transactions related to the sale of used equipment.

AB 2062 addresses the above issues by establishing a uniform method of calculating market and book values and establishing a \$500 exemption.

- e) **Automated Decision Systems (ADS).** Credit unions, like many other financial services companies, use ADS to help create efficiencies in their operations. However, amid ongoing state and national conversations about how private sector entities use ADS, the CCUL argues that specific authority to use these systems to help manage member applications would be beneficial. AB 2062 clarifies this process and establishes the conditions in which a credit union can use ADS to help determine if someone is eligible to become a member of the credit union. As is the case under current law, the use of ADS does not allow a credit union to skirt or otherwise ignore its compliance obligations, which AB 2062 also reiterates by requiring the ADS to be regularly tested for compliance with all applicable laws and regulations.
- f) **Remote meetings.** Under the Corporations Code, a credit union may hold its annual meeting remotely until December 31, 2025. As noted in Comment #5, pending legislation

would remove that sunset date and permanently authorize annual shareholder or member meetings to be conducted remotely. Separately, the Credit Union Law establishes obligations for a credit union to hold an annual meeting as well as a special meeting of the members. AB 2062 would create consistency with the Corporations Code and pending legislation by allowing all these meetings to be conducted remotely, provided the credit union complies with certain process rules.

5) Related legislation.

AB 2908 (Chen), of the 2023-24 Legislative Session, removes the December 31, 2025 sunset date for a corporation's authorization to conduct annual shareholder meetings remotely via electronic means, thereby making that authority permanent. The bill removes the sunset date for similar authority for nonprofit corporations, nonprofit mutual benefit corporations, nonprofit religious corporations, and cooperative corporations. AB 2908 is pending on the Assembly Floor.

6) Previous legislation.

- a) SB 269 (Portantino), Chapter 762, Statutes of 2021, made assorted changes to California Credit Union Law, including changes related to examinations, the expulsion of members, inactive accounts, and audit committees.
- b) SB 1031 (Portantino), of the 2020-21 Legislative Session, was substantially similar to SB 269, described above. SB 1031 was voluntarily pulled by its author prior to its hearing in the Senate Banking and Financial Institutions Committee, in response to the COVID-19 pandemic and the limited capacity of the Legislature to enact new legislation.
- c) AB 2862 (Limon), Chapter 267, Statutes of 2018, enacted five provisions intended to modernize the California Credit Union Law and increase parity between state-chartered and federally-chartered credit unions.
- d) AB 2274 (Dababneh), Chapter 353, Statutes of 2016, enacted six provisions intended to modernize the California Credit Union Law and increase parity between state-chartered and federally-chartered credit unions.

7) Support.

AB 2062 is sponsored by CCUL, who writes:

Credit unions have the option of either being state-chartered or federally chartered entities. Federally chartered credit unions are regulated by the National Credit Union Administration (NCUA) and in California, state-chartered credit unions are regulated by the Department of Financial Protection and Innovation (DFPI). Both federal and state governments periodically update their charters to stay competitive in their appeal and to create an even playing field in the dual charter system. This bill makes necessary updates to the state charter that are outlined below and upholds the incentive for state-chartered credit unions to benefit from having a regulator with a local perspective. AB 2062 allows credit unions to keep

up with the ever-changing landscape and best serve their members and communities across California.

REGISTERED SUPPORT / OPPOSITION:

Support

California Credit Union League (sponsor)

Opposition

None on file.

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