FINAL STATEMENT OF REASONS

UPDATE OF INITIAL STATEMENT OF REASONS

Section 30.102, subdivision (a)(4)(H)

The Department has made a non-substantive amendment to this section to reflect the proposed amendments to Section 30.300. Specifically, the reference to “Section 30.300(b)(6)” is amended to “Section 30.300(b).”

Section 30.200, subdivision (b)

The Department made a non-substantive amendment for grammatical purposes.

Section 30.300, subdivision (b)

The Department initially proposed that this subdivision be amended to allow a credit union’s total investment in the securities issued by a single person to be up to 10 percent of its equity, rather than prescribing a list of pre-authorized investments. However, the Department received comments stating that the meaning of the terms “equity” and “person” needed additional clarity. As a result, the term “equity” is amended to “equity capital” as that term is defined in Financial Code section 14400. Also, this subdivision is amended to clarify that the definition of “person” is the same as in Financial Code section 14001.1. Using these definitions is necessary to provide clarity and consistency with how these terms are used elsewhere in Credit Union Law.

The Department initially proposed removing the allowance for investments in an "investment company" (commonly known as a "mutual fund") as defined in the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1 et seq.) or trusts provided all investments and investment practices of the investment company or trust would be permissible if made directly by federal credit unions. However, based on comments received, this allowance will be retained.

Similarly, the Department initially proposed removing from the list of permissible investments (i) investments in deposits of authorized financial institutions, and (ii) investments in funds sold to authorized financial institutions, provided that the interest or other consideration received from the authorized financial institution is the market value of federal funds transactions and that the transaction has a maturity of one or more business days or the credit union is able to require repayment at any time. Based on comments received, these allowances will be retained.

The Department has also made non-substantive amendments to add numbering for ease of reading.

Section 30.300, subdivision (d)

The Department initially proposed deleting several definitions from this subdivision. However, based on the above changes made in response to comments, these Department will retain the definitions of “authorized financial institution,” “federal funds transaction,” and “market price”

to ensure that these terms remain defined for purposes of interpreting other subdivisions of this section.

Additionally, the Department initially proposed adding language that explained that an investment made pursuant to this section may still be deemed unsafe pursuant to Financial Code section 14204. However, based on concerns that the proposed regulation does not provide sufficient clarity about the Department's process of evaluating whether an investment is unsafe, the Department has removed this language.

The Department has also made non-substantive amendments to reflect the resulting renumbering of this subdivision.

Section 30.803, subdivision (a)

The Department initially proposed removing references to NCUA Regulations 701.21 (c)(5) and 701.21(d)(8). However, based on closer review of relevant statutes and comments received that these sections will provide needed clarity, these references will be retained.

Further, the dates of publication of the cited federal regulations have been removed based on the exception from this requirement provided in California Code of Regulations, title 1, section 20, subdivision (c)(4). Because 12 Code of Federal Regulations part 741.203 requires the adoption or enforcement of the federal regulations incorporated by reference, no specific date is required to be included in the text of the regulations. That federal regulation states that a federally insured, state-chartered credit union must comply with parts 723, 701.21, subdivision (c)(8), and 701.21, subdivision(d)(5) unless "the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board or, in the case of the commercial lending and member business loan requirements, if the state supervisory authority administers a state commercial and member business loan rule for use by federally insured credit unions chartered in that state that at least covers all the provisions in part 723 of this chapter and is no less restrictive, upon determination by NCUA." This change is necessary because it clarifies for California-chartered credit unions that California has not adopted a regulation that is stricter than the federal regulation, as contemplated by 12 Code of Federal Regulations, part 741.203.

Finally, after the Notice of Third Modifications and Proposed Third Modified Text were issued, the Department made non-substantive amendments to correct the citation format of 12 C.F.R. 701.21(d)(5).

Section 30.803, subdivision (b)

The Department determined that the proposed non-substantive grammatical amendments to this subdivision are no longer needed based on modifications made to subdivision (a) of this section.

LOCAL MANDATE DETERMINATION

The proposed regulations do not impose any mandate on local agencies or school districts.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL NOTICE PERIOD OF JUNE 26, 2020 THROUGH AUGUST 10, 2020

The Department received five public comment letters and emails during the 45-day public comment period. The comments are summarized below, together with the Department's response.

Comments Received from Styskal, Wiese & Melchione, L.L.P. (SW&M) in Letter dated August 10, 2020

Comment No. 1

SW&M makes general comments supporting updates to the regulations to reflect statutory amendments. It states that the changes will correct many inconsistencies in the regulations and provide easier avenues to communicate with the Department. Additionally, it states that the proposed amendments will give credit unions the opportunity to thrive and grow.

Response

The Department agrees with these general comments.

Comment No. 2

SW&M is concerned that the regulations do not direct how a credit union should manage risk of expanded investments, or specify how that risk will be evaluated under the proposed amendments. Specifically, it states, "SW&M is concerned with the lack of direction from the DBO as to how Credit Union Boards of Directors should manage the risk of the expanded investments, or how such risk will be evaluated by examiners under the new framework. The regulation continues to state that a Board must draft and comply with "a written investment portfolio with respect to the yield, maturity, liquidity and diversification, and risk management for its investments." But now that the investments themselves appear to be restricted only by the requirement that "securities issued by any one person will not exceed "10 percent of the credit union's equity" there is concern as to how the regulators will evaluate the safety and soundness of each investment." It also states that the requirement that the investment policy must address "risk management" for each investment and the ability for the Commissioner to find an investment is unsafe suggests that the Department may take serious action if investments are deemed unsafe. It states that the breadth of the regulation also carries "perils of unequal, inconsistent, and unfair enforcement."

Response

The Department disagrees. Risk management is an evaluation to be commensurate to the risk within the individual credit union's policies and will continue to be evaluated on a case-by-case basis. The risk profile of different investments vary by type as well as the current economic environment and market. We cannot quantify all types or scenarios in the regulations. Risk management is the process of identification, analysis, and response to risk factors that affect an investment. Risk can be measured individually within a particular investment, a group of

investments held (diversity is a risk mitigation practice), a specific industry or sector, economic environment, market risk, liquidity risk or other elements on the balance sheet (loans/other investments), and also the experience of management to assess such risks. Additionally, the overall goals of the credit union should be considered. It would be difficult to address all possible scenarios in a regulation.

Comment No. 3

SW&M suggests that there is a conflict between proposed section 30.300 and the allowances for investment under Financial Code sections 14650 and 14651, and California Code of Regulations, title 10, section 30.306. Specifically, it states that the proposed amendment has the potential to further limit investments such that a credit union would not be permitted to invest in a credit union service organization (CUSO) beyond 10%. It also states, "If this was the intended effect of the regulation, we believe sufficient notice of that should be provided to credit unions to allow for adequate comment on the true impact of the regulation. If it is the intended impact, we also do not believe that such a regulatory limitation would be in the best interests of credit unions as an unusual and undue limitation on CUSO investment powers. If the DBO proposes to limit investments in CUSOs, we would recommend review of and adherence to the limitations to which federal credit unions are subject to provide for consistency in standards and interpretation."

Response

The Department disagrees. Regulations regarding investments made pursuant to Financial Code sections 14650 and 14651, including investments in CUSOs, are found in title 10, California Code of Regulations, section 30.306. By contrast, Section 30.300 explicitly only applies to investments made pursuant to Financial Code section 14652, 14653, and 14653.5. Therefore, no further clarification is needed.

Comment No. 4

SW&M states that the term "equity" is not defined.

Response

The Department agrees and has revised the term "equity" to "equity capital", as that term is defined in Financial Code section 14400.

Comment No. 5

SW&M points out that the term security is defined to include "obligations" but that it does not clarify which obligations of a credit union are included. Specifically, SW&M asks whether this term, in relation to the proposed amendments to Section 30.300, is intended to interact with either the ability of credit unions to invest in loans or obligations of their members, or loans to CUSOs, whether or not they are members of the credit union. It also notes that a regulatory attempt to allow provision of loans to nonmembers may exceed the legislative scope of the California Credit Union Law. SW&M also states that clarity is needed on what obligations, if any, are not subject to the 10% of equity limitation.

Response

The Department disagrees. Financial Code section 14950 addresses the authority of a credit union to enter into an obligation with a member (e.g. loans). Section 30.300 is only addressing investments made by a credit union in securities. The two sections are independent of each other and do not interact (e.g. a credit union would not make an investment in its own loan to a member or nonmember). Laws related to loans are independent of the laws applicable to investments. Regarding whether any obligations are not subject to the 10% limit, the text of the proposed language already states that obligations of the United States and those for which the faith and credit of the United States are pledged for the payment of the principal and interest are not subject to this limit. In response to other comments received, the Department added has revised subdivision (b) to allow a credit union to invest in the shares of an "investment company" (commonly known as a "mutual fund") or trusts provided all investments and investment practices of the investment company or trust would be permissible if made directly by the credit union or federal credit unions, as is currently permitted.

Comment No. 6

SW&M states that clarification is needed regarding how to calculate the 10% limit if the rule includes derivatives in the definition of “security.” Specifically, it asks how the 10% limit’s numerator should be calculated since derivative positions can be valued in multiple ways.

Response

The Department disagrees. Derivatives are investments and therefore subject to the 10% cap. The derivatives should be calculated based on current applicable accounting standards and Generally Accepted Accounting Principles, and so reflected in the financial records of the credit union. To require the Department to list valuation methodology for all possible types of investments that should be included in the numerator would not be practical.

Comment No. 7

SW&M asks, in reference to Section 30.300(a)(2), whether any investments listed in Financial Code section 14652, 14653, and 14653.5 are considered “safe.” SW&M raised concern that based on past experiences, there is a concern that credit unions will be pressured to divest of permissible investments, despite significant documentary evidence of due diligence. SW&M recommends clarifying that the investments listed in these Financial Code sections are specifically authorized by the Department.

Response

The Department does not agree that it should declare any investment listed in section 14652, 14653, or 14653.5 as “safe”. Each investment that a credit union makes should be evaluated by that credit union to determine whether it is a safe and sound investment. As addressed in the Department’s Response to Comment 2 submitted by SW&M, risk management is an evaluation to be commensurate to the risk within the individual credit union’s policies and will continue to be evaluated on a case-by-case basis.

Comment No. 8

SW&M recommends further revisions to 30.300 to include guidelines similar to those in the National Credit Union Administration's (NCUA) regulations (12 CFR 703.3 and 741.3, subdivision (b)).

Response

The Department disagrees. In response to this comment, the Department considered creating parity with federal credit unions. However, after careful consideration of the federal regulations in comparison to applicable state laws, including the permissible investments in Chapter 10 (commencing with Section 800) of Division 1 of the Financial Code, the Department has chosen to instead provide a 10% authorization of equity capital in any one person. The Department believes this provides a broad authorization without creating safety and soundness concerns, and will avoid the need to update regulations in the future to contemplate investments to add to the list of permissible investments.

Comment No. 9

SW&M expresses concerns that Section 30.300 may not be consistent, in part, with 12 CFR 741.8 and 741.3(a)(2), which applies to federally-insured state-chartered credit unions.

Response

The Department disagrees. The California regulations only explain the types of investments permitted pursuant to state law. They do not interfere with a federally insured state-chartered credit union's obligations under the NCUA's regulations, for example with regard to establishing special reserves or providing notification to the NCUA Regional Director.

<u>Comments Received from Valley Strong Credit Union (Valley Strong) in Letter dated August 10, 2020</u>

Comment No. 1

Valley Strong makes general comments in support of proposed revisions to allow greater flexibility in investment strategy. It also notes, "The current regulatory limits on investments are outdated and unduly restrictive, and this is a necessary area for regulatory consideration and reform. We agree with the DBO that the authorized list of investments in the current version of§ 10 CCR 30.300 does not reflect the types of investments in which credit unions are investing."

Response

The Department agrees with these general comments.

Comment No. 2

Valley Strong states that the proposed regulations do not provide sufficient direction regarding the steps that a credit union must take to comply with the new regulations and asks for more

particular guidance regarding how regulators will evaluate the safety and soundness of each investment, and what documentation is required to satisfy Section 30.300, subdivision (a)(2). It also states that the breadth of the regulation accompanied by arbitrary enforcement would not be in its interest and could have major impacts on long-term investment strategies.

Response

The Department disagrees for the reasons stated in its Response to Comments No. 2 and No. 7 submitted by SW&M.

Comment No. 3

Valley Strong states that the term “equity” is not clear because it is undefined and asks for clarification of whether Allowance for Loan and Lease Losses or similar reserves are permitted to be included in the denominator for this calculation.

Response

The Department agrees that the term “equity” could be clearer for the reasons stated in its Response to Comment No. 4 submitted by SW&M and will therefore use the term “equity capital” as defined in Financial Code section 14400.

Comment No. 4

Valley Strong states that clarification is needed regarding the term “obligation.” Specifically, how the inclusion of “obligation” in the definition of “security” is intended to interact with a credit union’s ability to invest in loans or obligations of their members, if there are any obligations that are not subject to the 10% limit, and to which obligations this regulation is applicable.

Response

The Department disagrees for the reasons stated in its Response to Comment No. 5 submitted by SW&M.

Comment No. 5

Valley Strong states that clarification is needed regarding how to calculate the 10% limit if the rule includes derivatives in the definition of “security.” Specifically, it asks how the 10% limit’s numerator should be calculated since derivative positions can be valued in multiple ways.

Response

The Department disagrees for the reasons stated in its response to Comment No. 6 submitted by SW&M.

Comment No. 6

Valley Strong comments that clarification is needed of whether the 10% investment limit impacts the recently enacted Financial Code section 14659.

Response

The Department disagrees. Financial Code section 14659 states that investments pursuant to that section are not subject to the specific authorization requirements of Financial Code section 14653.5. The proposed 10% authorization is only applicable for investments made pursuant to Financial Code section 14653.5. Therefore, no additional clarity is needed on this point.

Comment No. 7

Valley Strong states that clarification is needed regarding whether the 10% limitation is applicable to credit union service organization (CUSO) investments.

Response

The Department disagrees. Section 30.306, subdivisions (b) and (c) already addresses limitations on CUSO investments. Further, the proposed language in section 30.300, subdivision (b) explicitly states that the 10% authorization only applies to investments made pursuant to Financial Code section 14653.5.

Comment No. 8

Valley Strong states that clarification is needed regarding whether only the investments listed in Financial Code section 14652, 14653, and 14653.5 are permissible, notwithstanding the language stating the investment in a security is permissible if it does not exceed 10% of the credit union's equity. Alternatively, Valley Strong states that the Department to clarify whether the investments in these same Financial Code sections will always be considered safe and sound for purposes of examinations.

Response

The Department disagrees. The investments made pursuant to 14652, 14653, and 14653.5 are permissible, but in addition to those explicitly permitted pursuant to these sections and the regulations, Financial Code 14653.5 still provides a means for the credit union to seek approval of other investments. The Department also disagrees that clarity is needed to explain that investments made pursuant to Financial Code section 14652, 14653, and 14653.5 are always safe and sound for the reasons stated in its Response to Comment No. 7 submitted by SW&M.

<u>Comments Received from the California Credit Union League (League) in Letter dated July 23, 2020</u>

Comment No. 1

The League provides general comments in support of the proposed rulemaking, stating that it broadens the investment authority for California credit unions. It also states that the proposed limit of 10 percent of the credit union's equity is appropriate, would not unduly constrain credit unions, and is consistent with other thresholds in credit union law. The League also provides general comments in support of the proposed amendments regarding the applications requirements of foreign (other state) credit unions wanting to do business in California.

Response

The Department agrees with these general comments.

Comment No. 2

The League states that additional clarity is needed in the proposed regulations regarding the definition of “security.” Specifically, it states that including the term “security” in the definition of security is circular, and also proposes that the term specifically include equities, bonds, mutual funds, for example.

Response

The Department has not proposed any changes to the definition of “security;” therefore, the League’s comment regarding the definition of “security” will not be addressed here.

Comment No. 3

The League also states that the definition of “security” should be clarified to explain that “authorized for investment” is in reference to Financial Code sections 14652, 14653, and 14653.5

Response

The Department disagrees that this is necessary. Section 30.300 explicitly states that this section is related to Financial Code sections 14652, 14653, and 14653.5. Therefore, additional clarification is not needed.

Comment No. 4

The League states that the term “person” should be defined and clarified as to whether investments issued by foreign corporations and foreign business corporations are permissible.

Response

The Department agrees and has modified the language to reference California Financial Code section 14001.1, which states that the term “person” has the same meaning as in Corporations Code 5065.

Comment No. 5

The League states that the term “equity” should be defined or replaced with the term “equity capital” for clarification.

Response

The Department agrees for the reasons stated in its Response to Comment No. 4 submitted by SW&M and will therefore use the term “equity capital” as defined in Financial Code section 14400.

Comment No. 6

The League recommends that the regulations permit a credit union to develop a reasonable plan, as agreed to by the Commissioner, to unwind investments determined by the Department to be unsafe, and that such plan should be based on the individual, unique circumstances and market conditions.

Response

The Department disagrees that additional language is needed in the regulations to allow for such a plan. Financial Code section 14204 states that if a credit union is conducting its business in an unsafe or unauthorized manner, the commissioner may require the credit union to temporarily suspend or cease those practices. That section does not dictate the timeline for when the Department must order such suspension or cessation. Historically, it has been the Department's practice to discuss with the credit union a plan and timeline to address the issue in a manner that minimizes harm to the credit union or its members.

However, there may be circumstances where immediately unwinding investments is in the best interest of a credit union and its members. The timing and method of how to address unsafe investments must be made on a case-by-case basis. Modifying this regulation to permit a credit union to develop a reasonable plan could create confusion that the credit union should always be given time to develop that plan, which would not be appropriate in every situation. Finally, to state in regulations that a credit union should be permitted to develop a "reasonable plan" would create a subjective, ambiguous, and uncertain standard as to what is considered "reasonable."

Comment No. 7

The League opposes the repeal of Section 30.101.5, subdivision (b), requiring the foreign (other state) credit union to identify the state where chartered. It disagrees that the requirement is duplicative of Financial Code 16009, which requires a foreign (other state) credit union to post at a conspicuous place at the office a notice to the public that identifies the state in which it was organized or chartered. The League recommends that foreign (other state) credit unions be required to identify the state where chartered in connection with any advertising or use of its name in California.

Response

The Department disagrees. Regulations may not exceed the authority of the related statute. Here, if the Department were to propose such language in the rulemaking, it would exceed the scope of Financial Code section 16009, which is explicitly only related to notification to the public at the foreign (other state) credit union's office. Section 30.101.5, subdivision (b) should be repealed because it is duplicative of Financial Code section 16009.

Comment No. 8

The League comments that the date of reference to the Federal Regulations cited in the proposed amendments of Section 30.803 should be removed to avoid questions of whether subsequent amendments to these regulations will be effective as to California credit unions.

Response

The Department agrees. Initially, the Department included the date based on the understanding that failure to do so would violate the requirement of California Code of Regulations, title 1, section 20, subdivision (c)(4). However, upon further consideration, it appears that no specific date is required based on the exception in California Code of Regulations, title 1, section 20, subdivision (c)(4). Title 12 of the Federal Regulations, section 741.203 requires federally insured state-chartered credit unions to comply with parts 723, 701.21(c)(8), and 701.21(d)(5) of Title 12 of the Federal Regulations. The only exception to this is if the chartering state adopts a stricter regulation. Therefore, this section contemplates that a state may follow the requirements set forth in these federal regulations, thus authorizing such duplication of these federal regulations. Further, by stating that California federally insured, state-chartered credit unions must comply with these federal regulations, it clarifies for these credit unions that California has not adopted a regulation that is stricter than the federal regulation, as contemplated by part 741.203.

<u>Comments Received from Trust Mutual Funds for Credit Unions by Credit Unions (TCU) in Letter dated August 10, 2020</u>

Comment No. 1

TCU provides general comments in support of the intention to allow credit unions greater flexibility in their choice of investments and to reduce redundant paperwork requirements for approval of routine investments.

Response

The Department agrees with these general comments.

Comment No. 2

TCU comments that clarification in Section 30.300 is needed as to whether obligations "authorized for investment by a credit union" includes those instruments authorized for investment by a federal credit union, or in the alternative, whether the proposed definition of a "security" includes shares of an investment company that invests exclusively in investments that are allowed to be made by a California state credit union. Alternatively, TCU requests that, because subdivision (b)(6) of Section 30.300 is proposed to be removed as permissible investment, that the Department clarify that mutual funds continue to be exempted from the definition of "risk asset."

Response

The Department agrees and has revised subdivision (b) to allow a credit union to invest in the shares of an "investment company" (commonly known as a "mutual fund") or trusts provided all investments and investment practices of the investment company or trust would be permissible if made directly by the credit union or federal credit unions, as is currently permitted. Also, the Department has made the non-substantive change to the reference to “Section 30.300(b)(6)” in Section 30.102, subdivision (a)(4)(H) to now reflect the revised reference to investments in mutual funds.

<u>Comments Received from George Uberti in Email dated July 11, 2020</u>

Comment No. 1

Mr. Uberti states that allowing a foreign (other state) credit union to submit an application in the format of its choice would make it more difficult to ensure out of state applicants have submitted all necessary information and greatly increase the burden on the Department in the application verification process. Mr. Uberti states that the application could be standardized by a single form, reducing the burden on the Department and greatly increasing the accountability produced by the application process.

Response

The Department disagrees. As explained in the Initial Statement of Reasons, technological advances have significantly changed the Department’s information-gathering and information-sharing methods. Because the Department is now able to retrieve information electronically that previously was only available from the applicant credit union in paper form, and this information can be accessed and provided electronically, there is no reason to require a paper application or to prescribe a specific format for the application. The Department disagrees that the use of a single-page standard form would lessen the burden or increase the accountability of the application process. The application still requires that the foreign (other state) credit union to provide a cover letter explaining how it satisfies the factors set forth in Section 16022 of the Financial Code, and to provide various exhibits. A single-page form cannot serve as a substitute for these documents.

Comment No. 2

Mr. Uberti suggests that the certain references to federal regulations in Section 30.803 be maintained. He states that the references are to regulations that restrict family members of credit union officials from receiving preferential treatment for loans over $20,000, and prohibit family members of credit union officials from receiving fees, compensation, or commissions on credit union loans. He states that while the same prohibitions may exist under state law, the knowledge of these laws increases the likelihood that they will be abided by, and that the interest of both credit union members, officials, and their families in being aware of these laws greatly outweighs the benefits that the Department may gain after going through the work of removing them. Mr. Uberti further suggests that if this section is to be amended, it should be

changed to remove the $20,000 allowance of preferential treatment that credit union official's family members receive on loans because it is a financial risk created without regard to what is fiscally responsible.

Response

The comment regarding federal regulations discussing the restriction of family members receiving preferential treatment for loans over $20,000 is outside the scope of this rulemaking. That restriction is found in 12 CFR 701.21 (d)(4), which is not a section currently referenced in Section 30.803, nor is it proposed in this rulemaking as one to be included.[1] The Department is not prepared to start subjecting state-chartered credit unions to such a rule without further study.

The Department agrees with the comment that other references to federal regulations should be maintained and therefore the Department will retain references to 12 CFR 701.21 (c)(5) and 701.21(d)(8).

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE FIRST NOTICE OF MODIFICATIONS PERIOD OF FEBRUARY 24, 2021 THROUGH MARCH 11, 2021

The Department received seven public comment letters or emails during the 15-day public comment period. The comments are summarized below, together with the Department's response.

Comments Received from the League

1. Email dated March 4, 2021

Comment

The League states that several credit unions voiced "considerable concern over proposed limits on investments that NCUA has no such limits." It states that this limit does not contemplate a credit union's use of a bank for correspondent services and asks for more background information about that proposed amendment.

Response

The Department agrees and proposes to retain the allowance for investing in deposits of authorized financial institutions, and to also retain the definition of authorized financial institutions.

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[1] The Department notes that the Informative Digest originally characterized one of these federal restrictions as prohibiting family members of a credit union official from receiving preferential treatment for loans over $20,000. The Information Digest should have instead explained that it is a restriction prohibiting an official, his immediate family member, or an individual having a common ownership, investment or other pecuniary interest in a business enterprise with an official or with an immediate family member of an official, from receiving preferential rates, or terms or conditions, on loans or lines of credit.

2. <u>Letter dated March 11, 2021</u>

Comment No. 1

The League states that it received feedback from multiple credit unions that "the proposed limit of 10 percent of the credit union's equity capital will prove to be overly restrictive and detrimental to credit union investment opportunities. In terms of concentration risk in general, what is deemed safe and sound will vary by each credit union, as some credit unions have the capability to take on a greater level of concentration risk than others based upon their financial condition, expertise, investment types, policies, and current economic conditions." It also suggests as an alternative to enforcing a restrictive blanket limitation on all credit unions, the Department should consider "each credit union's unique circumstances and raising any safety and soundness concerns with the individual credit union at the time of examination."

Response

The Department agrees that safety and soundness varies between each credit union and should be evaluated on a case-by-case basis.

However, the Department disagrees that this is a 10% limitation on investments. Rather, it is a authorization to invest up to 10% of equity capital in investments that are otherwise impermissible without prior written approval of the Commissioner pursuant to Financial Code section 14653.5. This has the effect of reducing the number approvals a credit union would be required to obtain, while preserving safety and soundness concerns that could come up with a higher threshold.

In other words, in reference to Financial Code section 14653.5, the proposed rule only speaks to the portion of that section that states, "a credit union may make any investment authorized by regulation […]" and has no impact on investments authorized "in writing by the commissioner." This authorization to invest up to 10% of equity capital would not prevent a California state-chartered credit union from seeking written approval to invest in a greater amount pursuant to Financial Code section 14653.5.

Comment No. 2

The League states that, although a credit union may be able seek to invest more than 10%, that option is not clear, "especially when compared with comparable language in 30.306 regarding investments in fixed assets and service corporations." The League again urges the Department to "remove the 10 percent limitation."

Response

The Department disagrees. Although both section 30.306 and 30.300, subdivision (b) discuss a 10% threshold, section 30.306 imposes a limit, then goes on to create the opportunity to seek written approval to exceed that limitation. Subdivision 30.300 does not need to include such language to allow for the opportunity to seek written authorization, as that is already provided in Financial Code section 14653.5. Stated another way, Section 30.300's proposed language

simply provides information about what type of investment is authorized by regulation, and does not impact whether a credit union may request written authorization to invest a greater amount.

Comment No. 3

The League states that "the imposition of a new blanket pre-approval requirement for concentration risk over a specified level not only fails to recognize the existing flexibility and unique circumstances of each credit union" and creates an administrative burden. The League also says that this "places into immediate question the ongoing permissibility of any existing investments currently outside this proposed new limitation."

Response

The Department disagrees. The proposed language does not create new restrictions to investments authorized by regulation, except for investments in Eurodollars, Yankee dollars, and bankers acceptances, which are generally not the type of investments that credit unions are currently making. Instead, it creates an opportunity for credit unions to avoid the administrative burden of request written authorization from the Commissioner for investments less than 10%. If a credit union has already received written authorization for an investment, that pre-existing *written* authorization is not impacted by this proposed language, as this language only applies to the section of Financial Code section 14653.5 that discusses investments authorized *by regulation*.

Comment No. 4

The League points out that part 703 of NCUA Rules and Regulations do not "impose a blanket limitation. Rather, NCUA rules place limits on certain investment activities that may be deemed higher risk. For California state-chartered credit unions to have the ability to compete in the marketplace, their approved investment authority should be on a level equal to federally chartered credit unions in Part 703." The League urges the Department to create parity with federal credit unions.

Response

In response to this comment, the Department considered creating parity with federal credit unions. However, after careful consideration of the federal regulations in comparison to applicable state laws, including the permissible investments in Chapter 10 (commencing with Section 800) of Division 1 of the Financial Code, the Department has chosen to instead provide a 10% authorization of equity capital in any one person. The Department believes this provides a broad authorization in a manner that does not create safety and soundness concerns, and will avoid the need to update regulations in the future to contemplate investments to add to the list of permissible investments.

Comment No. 5

The League explains that corporate credit unions play an important role, "providing core financial services, clearing house services, liquidity, and investment services to many credit

unions." It further states that the "10 percent limitation would create an unnecessary regulatory burden on many credit unions and, as a result, hamper their relationship with their corporate credit unions in terms of the credit union's ability to utilize their core services."

Response

The Department agrees for the reasons stated in its Response to the Comment in the Email dated March 4, 2021 from the League.

Comment No. 6

The League states that the language authorization investments in a mutual fund in section 30.300, subdivision (b) is oddly worded and therefore has the potential to create confusion. It strongly recommends the language be amended for clarity.

Response

The Department agrees and has proposed modifications to this language for clarity.

Comment No. 7

The League comments that the date of reference to the Federal Regulations cited in the proposed amendments of Section 30.803 should be removed to avoid questions of whether subsequent amendments to these regulations will be effective as to California credit unions. It also states that this would result in removing parity with federal credit unions.

Response

The Department agrees. Initially, the Department included the date based on the understanding that failure to do so would violate the requirement of California Code of Regulations, title 1, section 20, subdivision (c)(4). However, upon further consideration, it appears that no specific date is required based on the exception in California Code of Regulations, title 1, section 20, subdivision (c)(4). 12 Code of Federal Regulations, part 741.203 requires federally insured state-chartered credit unions to comply with parts 723, 701.21, subdivision (c)(8), and 701.21, subdivision(d)(5). The only exception to this is if the chartering state adopts a stricter regulation. Therefore, this section contemplates that a state may follow the requirements set forth in these federal regulations, thus authorizing such duplication of these federal regulations. Further, by stating that California federally insured, state-chartered credit unions must comply with these federal regulations, it clarifies for these credit unions that California has not adopted a regulation that is stricter than the federal regulation, as contemplated by part 741.203.

<u>Comments Received from LBS Financial Credit Union</u>

Please note that portions of the following comments have been redacted to preserve confidentiality – see Government Code section 6254, subdivision (d) and Financial Code section 159.

1. <u>Letter dated March 1, 2021</u>

Comment

LBS Financial Credit Union requests parity with federal law to remove the “10 percent limit of the credit union's equity to any one person.” Alternatively, it proposes that the regulation be further amended to provide that deposits in national or state banks along with obligations of the United States are not subject to this limit, as is currently permitted.

Response

The Department agrees for the reasons stated in its Response to the Comment in the Email dated March 4, 2021 from the California Credit Union League.

2. <u>Email dated February 25, 2021</u>

Comment

LBS Financial Credit Union requests that the proposed regulation be further amended to provide that deposits in national or state banks along with obligations of the United States are not subject to this limit, as is currently permitted.

Response

The Department agrees for the reasons stated in its Response to the Comment in the Email dated March 4, 2021 from the California Credit Union League.

3. <u>Email dated February 24, 2021</u>

Comment

LBS Financial Credit Union expressed concerns about the proposed deletion of Section 30.300, subdivision (b)(5) and asked for clarification of whether it could “continue to invest funds with [bank] as a part of our board approved Investment Policy.”

Response

The Department agrees that further clarification is needed regarding investments in deposits for authorized financial institutions for the reasons stated in its Response to the Comment in the Email dated March 4, 2021 from the California Credit Union League.

Comments Received from TCU in Letter dated March 10, 2021

Comment

TCU expresses general comments of support for the amendment to Section 30.300(b) to allow a California credit union to invest in a mutual fund without limit so long as the mutual fund limits its investments either to instruments that are permissible if made directly by the California credit union or if made directly by a federal credit union. It also supports the revised definition of "risk assets" because it will "continue the treatment of mutual funds offered to credit unions that limit their holdings to permissible investments." Finally, it states that the proposed rules "move California credit union regulation toward the beneficial goal of allowing credit unions greater flexibility in their choice of investment and reducing redundant paperwork required for routine investments."

Response

The Department agrees with these general comments.

Comments Received from George Uberti in Email sent February 24, 2021

Comment

Mr. Uberti states he respects the Department's "decision to hear the public's voice on these matters and commit to keeping an expedient and simplified regulatory framework in place to protect Californians and their financial interests."

Response

The Department agrees with these general comments.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE SECOND NOTICE OF MODIFICATIONS PERIOD OF APRIL 23, 2021 THROUGH MAY 10, 2021

The Department received two public comment letters during the second 15-day public comment period. The comments are summarized below, together with the Department's response.

Comments Received from the League in letter dated May 10, 2021

Comment No. 1

The League states general comments in support of the modifications. Specifically, it states, "The Second Modifications clarify that a credit union may invest more than 10 percent of its equity capital in the securities of a person if it receives the prior written authorization of the Commissioner." It also supports the clarification of which investments are authorized without limit by regulation. It further states, "We believe that, by the removal of the restrictive blanket limitation, credit unions are now capable of having broader investment opportunities. The

elimination of the blanket limitation also gives the DFPI the ability to consider each credit union’s unique circumstances and raise any safety and soundness concerns with the individual credit union at the time of examination.” Finally, it states its support of the retention of the definitions “authorized financial institution,” “federal funds transaction,” and “market price.”

Response

The Department agrees with these general comments.

Comment No. 2

The League states that clarity is needed of whether “bank notes are contemplated in the list of permissible investments in the Second Modifications.” It states that in order to achieve parity with federally chartered credit unions, this should be permitted and clarified.

Response

The Department disagrees. This comment is outside the scope of this rulemaking. The current regulations do not specifically provide authorization for bank notes, and the Department is not prepared at this time to create in regulation the authority for a credit union to invest in bank notes in an amount greater than 10% of its equity capital. However, a credit union may apply for written authorization, pursuant to Financial Code section 14653.5, to invest a greater amount.

Comment No. 3

The League comments that the date of reference to the Federal Regulations cited in the proposed amendments of Section 30.803 should be removed to avoid questions or confusion of whether subsequent amendments to these regulations will be effective as to California credit unions. It also states that this would result in removing parity with federal credit unions.

Response

The Department agrees. Initially, the Department included the date based on the understanding that failure to do so would violate the requirement of California Code of Regulations, title 1, section 20, subdivision (c)(4). However, upon further consideration, it appears that no specific date is required based on the exception in California Code of Regulations, title 1, section 20, subdivision (c)(4). 12 Code of Federal Regulations, part 741.203 requires federally insured state-chartered credit unions to comply with parts 723, 701.21, subdivision (c)(8), and 701.21, subdivision(d)(5). The only exception to this is if the chartering state adopts a stricter regulation. Therefore, this section contemplates that a state may follow the requirements set forth in these federal regulations, thus authorizing such duplication of these federal regulations. Further, by stating that California federally insured, state-chartered credit unions must comply with these federal regulations, it clarifies for these credit unions that California has not adopted a regulation that is stricter than the federal regulation, as contemplated by part 741.203.

Comments Received from Patelco Credit Union in Letter dated May 4, 2021

Comment No. 1

Patelco Credit Union states comments in support of the amendments to "afford credit unions broader investment choices and eliminate the requirement to obtain the Department's prior approval for routine investments." It states that these changes offer greater flexibility in investment options and provide greater parity to federally chartered credit unions.

Response

The Department agrees with these general comments.

Comment No. 2

Patelco Credit Union states that, to allow for equal competition, state-chartered credit unions should have full parity with federal credit unions with regard to permissible investments.

Response

The Department disagrees. The Department considered creating parity with federally chartered credit unions. However, after careful consideration of the federal regulations in comparison to applicable state laws, including the permissible investments in Chapter 10 (commencing with Section 800) of Division 1 of the Financial Code, the Department has chosen to instead provide a 10% authorization of equity capital in any one person. The Department believes this provides a broad authorization in a manner that does not create safety and soundness concerns, and will avoid the need to update regulations in the future to contemplate investments to add to the list of permissible investments.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE THIRD NOTICE OF MODIFICATIONS PERIOD OF NOVEMBER 9, 2021 THROUGH NOVEMBER 24, 2021

The Department received one public comment letter during the second 15-day public comment period. The comments are summarized below, together with the Department's response.

Comments Received from the League in letter dated November 24, 2021

Comment No. 1

The League states that it has received feedback that "that the proposed limit of 10 percent of the credit union's equity capital remains too restrictive." The League further explains that there are situations that present "various risks where it would be prudent to respond quickly and diversify. The proposed 10 percent limit would be insufficient to allow credit unions the flexibility to respond in a manner best suited to ensure their long-term safety and soundness." The League states that it is important for state-chartered credit unions to have "sufficient flexibility in their investment opportunities in order to more effectively respond to the constant ebbs and flows in the marketplace." The League states that the 10 percent limitation should be removed.

Response

The Department disagrees for the reasons stated in its Response to Comment No. 1 in the League's letter dated March 11, 2021.

Comment No. 2

The League states that the proposed investment regulations "do not put state-chartered credit unions on equal footing with federally chartered credit unions." Specifically, it points out that federally chartered credit unions are permitted to invest in bank notes with weighted maturities of less than five years. The Leagues states that it is unclear whether bank notes are contemplated in the "list of permissible investments." The League requests clarity to ensure parity.

Response

The Department disagrees for the reasons stated in its Response to Comment 2 in the letter dated May 10, 2021 from the League.

Comment No. 3

The League supports the removal of the date of reference Section 30.803, subdivision (a) for the applicable federal regulations.

Response

The Department agrees with this general comment.

ALTERNATIVES THAT WOULD LESSEN ADVERSE ECONOMIC IMPACT ON SMALL BUSINESS

Credit Unions are not small businesses under Government Code section 11342.610, subdivision (b), and therefore no alternatives would lessen the impact of the proposed regulations on small businesses.

ALTERNATIVES DETERMINATION

The Department has determined that no alternative it considered or that was otherwise identified and brought to its attention would be more effective in carrying out the purposes for which the regulation is proposed, would be as effective and less burdensome to affected private persons than the adopted regulation, or would be more cost effective to affected private persons and equally effective in implementing the statutory policy or other provision of law.

The regulations adopted by the Department are the only regulatory provisions identified by the Department that accomplish the goal of protecting the interests of credit unions and their members. Except as set forth and discussed in the summary and responses to comments, no other alternatives have been proposed or otherwise brought to the Department's attention.

STATEMENT REGARDING INCORPORATION BY REFERENCE

It would be cumbersome, unduly expensive or otherwise impractical to publish 12 Code of Federal Regulations parts 723, 701.21, subdivision(c)(8), and 701.21, subdivision (d)(5) in the California Code of Regulations because there are more than ten sections of federal law incorporated by reference, which would be quite lengthy to publish in the California Code of Regulations.

The federal laws incorporated by reference were reasonably available to the affected public from commonly known resources, including public libraries, popular search engines, and publicly available websites, including the National Archives' Code of Federal Regulations website.