L&T Bulletin: Amendments to the Illinois Credit Union Act

Highlights

- On May 13, 2022, Governor JB Pritzker signed HB 4462 into law as Public Act 102-0774. All provisions in the bill were effective on that date, exception new Illinois Credit Union Act (ICUA) Section 16.5 addressing service to CDFI target markets. Section 16.5 takes effect January 1, 2023.

- HB 4462 was an initiative of the Illinois Credit Union League and it makes several beneficial amendments to the ICUA (205 ILCS 305/1 et seq.).

Governor Pritzker Approves ICUL-Initiated Legislation Amending Illinois Credit Union Act

- HB 4462, as amended, unanimously passed the House of Representatives on March 4, 2022, and then it unanimously passed the Senate on March 31, 2022. It was sent to Governor Pritzker on April 28, 2022 and he approved it on May 13, 2022, as P.A. 102-0774 with an immediate effective date (except new Section 16.5, which has an effective date of January 1, 2023.

- HB 4462 amends the ICUA to make several technical amendments that will enable Illinois credit unions to operate more efficiently in serving their members. Illinois is a strong state for state-chartered credit unions and the measure helps ensure those credit unions remain competitive with other financial service providers doing business in Illinois.

This Bulletin provides a section-by-section analysis of each of the elements in the bill.

Section 16.5: Service to CDFI Target Markets

This new ICUA provision draws upon the federal Community Development Banking and Financial Institutions Act ("CDFI Act"; 12 U.S.C. 4702) and Department of Treasury regulations (12 CFR 1805.104 and 1805.201(b)(3)), to enable credit unions to serve "Target Markets" consisting of low income and minority groups ("Targeted Populations") and distressed geographic areas ("Investment Areas"). It is important to note terms used in new Section 16.5 that are not defined in the Section have the meanings ascribed to them in the Treasury regulations cited in the Section. Beyond the foregoing terms, other key terms include "low income", "financial products" and "financial services."

New Section 16.5 expands the scope of existing ICUA Section 16.1 to fully track the federal Treasury regulations that address the provision of financial services and financial products to the economically

disadvantaged.[1] With that authority, credit unions will be better able to fulfill their obligation to meet the financial services needs of their assessment areas under the new Illinois Community Reinvestment Act ("Illinois CRA", 205 ILCS 735/35-1 et seq.), consistent with their membership common bond(s) and safe and sound operation, and upon approval by the Illinois Department of Financial and Professional Regulation ("IDFPR" or "Department").

New Section 16.5 provides credit unions with an innovative new pathway to amend and expand their fields of membership. Target markets, consisting of persons who reside in Investment Areas, and Targeted Populations, consisting of individuals or identifiable groups of individuals who are low-income persons or lack adequate access to financial products or financial services, may be admitted to membership, in accordance with the terms of a business plan submitted to and approved by the Department. The plan must (i) confirm that the Target Market meets the applicable CDFI definitional criteria, (ii) identify the financial product and financial service needs of the Target Market, (iii) identify the financial products and financial services to be delivered, and (iv) identify the manner of delivery of those financial products and financial services. The Department in its discretion may approve, disapprove or require the credit union to modify the plan to seek approval of the Target Market as an occupational, community or associational common bond.

In addition to serving persons who reside in Investment Areas, a credit union may indirectly serve Investment Areas by making loans to or investments in CDFI's, minority depository institutions and other businesses that serve the Investment Areas, subject to existing loan and investment limits set forth in the ICUA. Credit unions have the same authority with respect to loans to or investments in CDFI's, minority depository institutions and other businesses that serve Targeted Populations.

Credit unions that are certified by the CDFI Fund as a CDFI may already do today what new Section 16.5 authorizes in terms of serving Target Markets. However, few credit unions meet the CDFI eligibility requirements and only a handful of credit unions in Illinois are certified. New Section 16.5 enables all Illinois credit unions to add Target Markets to their fields of membership. That may be of critical assistance, in terms of complying with the Illinois CRA when the Department promulgates its implementing regulations.

Section 19 and 20: Member Electronic Voting

HB 4462 amends ICUA Sections 19 and 20 to address member voting and references to the Illinois Electronic Commerce Security Act ("ECSA"), which was repealed in 2021 and replaced with the Uniform Electronic Transactions Act ("UETA"). UETA modernizes standards for the use of electronic records and electronic signatures. Illinois became the 49th State to adopt UETA.

The legislation adopting UETA (S.B. 2176; passed into law as Public Act 102-0038, eff. 6/25/2021), included locator amendments to other existing acts in which ECSA was referenced, including the ICUA. However, the legislation simply deleted the reference to ECSA and replaced it with UETA. The revisory failed to scrutinize the ICUA for references to substantive ECSA terms that aren't included in UETA. For example, ECSA used the term "secure electronic record," while UETA uses the term "security procedure." To avoid

[1] ICUA Section 16.1 only addresses Investment Areas and requires a credit union to maintain a facility (branch, shared branch or electronic facility, not including an ATM), in order to serve as members persons residing in the area.

any ambiguity, the amendments in Sections 19 and 20 relating to member electronic voting delete obsolete ECSA terms and insert proper UETA terms.

Section 20: Nominating Committee

This provision amends ICUA Section 20 to provide statutory authority for the Board of Directors to appoint a nominating committee.

Governing a depository financial institution has become increasingly complex and attracting qualified and competent Directors has also become more challenging for many credit unions. As Boards grapple with developing appropriate policies relating to the recruitment, evaluation and nomination of eligible candidates to serve as Directors, it has become clear there is a total absence of any reference to the Board's ability to appoint and utilize a nominating committee to assist in the process. The amendment adds to the statutory list of committees a credit union Board may create to address that omission. However, the proposal imposes no unreasonable restraints with respect to the creation and operation of such a committee.

The new provision states that the Board of a credit union may appoint from among the members of a credit union a nominating committee of 3 or more persons. Member of the committee may, but need not, be directors or officers of the credit union. The statutory purpose of the nominating committee is to "recruit, evaluate, and nominate eligible candidates for each position to be filled in the election of directors or, in the event of a vacancy in office, to be filled by appointment of the board of directors for the remainder of the unexpired term of the director creating the vacancy."

The measure goes on to provide the factors the nominating committee may consider in evaluating prospective candidates include whether the candidate possesses or is willing to acquire through training the requisite skills and qualifications to carry out his or her statutory duties. Finally, the measure authorizes the board of directors to delegate to the nominating committee the same recruitment, evaluation and nomination duties for committee and executive officer positions.

Section 34: CECL Relief for Small Credit Unions

As a matter of federal parity, HB 4462 amends the ICUA to clarify that small credit unions (less than $10 million in assets) that do not have financial statement audits performed in accordance with GAAP (per existing authorization under ICUA Section 34(3)(A)), may determine their allowance for loan losses ("ALL") in accordance with any reasonable reserve methodology, provided it covers known and probable loan losses. Any such credit union may also engage a CPA to perform a financial statement audit in accordance with this regulatory basis of accounting (rather than per GAAP).

FASB establishes GAAP and if a credit union has a financial statement audit in accordance with GAAP ("external audit" under ICUA § 34), adherence to the new current expected credit losses ("CECL") standard will be required for all such credit unions regardless of asset size for fiscal years beginning after December 15, 2022. CECL requires recognition of lifetime expected credit losses measured at amortized cost, not just credit losses incurred at the reporting date. The consequence is an earlier recognition of credit losses. On August 2, 2021, the NCUA promulgated a rule to facilitate the transition of federally insured credit unions to CECL under GAAP. Consistent with regulations issued by the other federal banking regulators, it mitigates the adverse "day one" effect on PCA net worth classification with a 3-year phase-in period. Beyond that, it provides relief to small credit unions in relation to their allowance for loan losses("ALL") determination.

HB 4462 amends the ICUA to provide the same relief to small Illinois credit unions, regarding the determination of the appropriate balance in their ALL account. The measure provides that credit unions with assets of $5 million but less than $10 million shall now have 3 options concerning their annual financial statement review. The first option continues to be an agreed-upon procedures engagement performed by a CPA that minimally satisfies the supervisory committee internal audit standards set forth in the ICUA. The second option continues to be an external independent audit performed by a CPA. The new third option is to engage a CPA to perform a financial statement audit in accordance with the non-CECL regulatory basis of accounting described above.

Credit unions with assets of less than $5 million may also utilize the non-CECL regulatory basis of accounting to determine their ALL. As with credit unions in the $5 to $10 millions asset category, that option is available as long as the credit union doesn't have a financial statement audit prepared in accordance with GAAP

Section 39: Donor Advised Fund Accounts

As a clarification of their existing authority to make charitable contributions, HB 4462 amends ICUA Section 39 to provide that credit unions may establish donor advised fund accounts as a vehicle to make contributions to non-profit public charities exempt under IRC § 501(c)(3).

Credit unions have the existing authority to make charitable contributions and establish charitable donation accounts (CDA). A CDA is owned by the credit union and no less frequently than every 5 years, the credit union must distribute at least 51% of the total return on assets to IRC §501(c)(3) charitable organizations.

The amendment to Section 39 adds to that authority by permitting donor advised fund accounts. Pursuant to the new authorization, the credit union irrevocably transfers funds in the account to an IRC §501(c)(3) charity, who in turn makes grant distributions to IRC §501(c)(3) charitable organizations upon the direction of the credit union.

Unlike a CDA, where the credit union owns the account, with a donor advised fund account, the credit union irrevocably transfers from the account all right, title and interest in the funds to a foundation exempt from taxation under IRC § 501(c)(3). Based upon specific grant recommendations of the credit union, the foundation in turn distributes the funds to IRC § 501(c)(3) charities. The donor advised fund option affords the credit union the administrative convenience of making one transfer with several grant recommendations designating the entities that will receive the grant funds. It also helps the credit union avoid the cost, administrative expenses and reporting requirements associated with establishing its own private foundation.

Section 42: Member Personal Representative for Deceased or Disabled Non-Member

The amendment to ICUA Section 42 clarifies that a member who is a personal representative of a deceased or disabled non-member may establish an estate account for the deceased or disabled person.

Per existing law, a non-member may establish an executor/representative account for a deceased or disabled member. If a person with no relationship with the credit union may establish such an account, then the person who is a member should be afforded the same opportunity for a deceased or disabled

non-member. It is logical that the member would go to his or her credit union where a relationship already exists to conduct those account activities.

The following chart illustrates the impact of the Section 42 amendment:

Shares in Trust

Statutory Standard	Establishment of Account in Name of Executor/Representative – Membership Status	Deceased/Disabled Person Credit Union Membership Status
Prior to HB 4462	Non-Member	Member
With HB 4462	Member	Non-Member

Section 59: Fintech Company Investment Authority

Section 59 of the ICUA addresses credit union investment authority. HB 4462 amends ICUA Section 59 to enable credit unions to invest in "fintech companies" that provide financial products or financial services that are of current or prospective benefit to credit unions, members and consumers eligible for membership.

The financial services marketplace is extraordinarily competitive and innovative tools, products and services are constantly emerging to meet the demands of consumers for more modern and automated software and other technologies to address the way in which they manage their finances. The amendment addresses that challenge by authorizing credit unions to invest in financial technology companies that support their current and prospective operational needs in those areas. The authorization is subject to several due diligence criteria to ensure safety and soundness with respect to the investment(s), including an aggregate investment cap, documentation standards and "pierce the corporate veil" liability limitation analyses. Additionally, language has been incorporated into the bill to ensure that a credit union is not authorized to invest in any fintech company that engages in predatory lending, by setting a cap on the annual percentage rate charged by a fintech company partnering with a credit union.

The measure broadly defines "financial technology company" to include any corporation, partnership, limited liability company, or other entity whose principal business is the provision of financial products or financial services, or both, that

i. Currently relate or may prospectively relate to the daily operations of credit unions;
ii. Are of current or prospective benefit to the members of credit unions; or
iii. Are of current or prospective benefit to consumers eligible for membership in credit unions;

and that applies technological interventions, including specialized software or algorithm processes, products or solutions to improve and automate the delivery and use of those financial products or financial services.

Based on the foregoing definitional standard, this new investment authority is much more expansive than the existing authority to invest in credit union service organizations ("CUSO's")[2]. Not every "fintech" is a CUSO, so the provision gives credit unions the flexibility of investing in an entity that may not yet be

[2] Under ICUA Section 1.1, a "CUSO" is an organization established to serve the needs of credit unions, the business of which relates to the daily operations of credit unions.

serving credit union members and may not yet be a CUSO. However, as set forth in the new provision, the credit union must still adhere to most of the CUSO due diligence investment requirements (separate corporate existence; "pierce the corporate veil" legal opinion that the fintech is established in a manner that limits the credit union's exposure to no more than the loss of funds invested in the fintech; and execution of investment agreement containing specified terms, such as Department access to the books and records of the fintech, adherence to GAAP, provision to the Department of quarterly financial statements and annual CPA audited financial statement; and specified investment termination clauses).

The fintech investment limit is structured on a tiered basis as follows:

Tier	CU CAMELS/Capitalization Status	Aggregate Fintech Investment Cap
1.	Composite Rating of 1 or 2; Well capitalized (per 12 CFR 702.102), even if net worth is reduced by the full investment amount at the time the investment is made or at any point during the time the investment is held; and Fintech maintains separate corporate existence.	2.5% of net worth
2.	Same as Tier 1, plus management rating of 1 at the time the investment is made and at all times during the term of the investment.	5.0% of net worth
3.	Same as Tier 2, with approval from Department for an exception to 5% limit.	10.0% of net worth
Note: "Net worth" is defined as "retained earnings" (undivided earnings and reserves (IDFPR Rule 190.2, 38 IL. Adm. Code, Section 190.2))		

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