

Expansion-Oriented, Tax-Exempt Credit Unions Compete Unfairly

Issue

With the passage of legislation in 1998 that relaxed the common bond requirements for credit unions, and through various regulatory actions that have expanded credit union product offerings, the distinction between banks and many credit unions is virtually nonexistent. Many credit unions' membership and product offerings are so bank-like they are merely "tax-exempt banks." It is inappropriate for the credit union industry, which Congress has granted tax-exempt status, to continue seeking expansion of its powers and membership opportunities, and thus its tax subsidy, to the detriment of U.S. taxpayers and non-subsidized competitors in the marketplace. Congress needs to revisit whether this new breed of expansion-oriented credit unions should continue to enjoy the benefits of a tax subsidy without a sound policy reason.

Background

- Historically, credit unions were created to serve market niches involving "people of small means" who lacked access to mainstream financial services. As a result, credit unions were granted tax-exempt status and exempted from other regulatory requirements (*e.g.*, CRA) applicable to mainstream financial players. But over the last decade the credit union industry has experienced explosive growth, serving a membership base and providing a product mix that is virtually indistinguishable from banks and savings associations.
- 123 credit unions currently hold **more than \$1 billion in assets** each. Others serve geographic areas as large as some states, or with population bases of more than 10 million people. These are hardly the traditional "mom & pop" credit unions that Congress intended to confer special status upon.
- Given the vast expansion in access to financial services experienced by the general population over the same time frame, the basis upon which the credit union charter was created no longer exists. ABA believes it is time for policymakers to reevaluate the special treatment afforded to credit unions, particularly for those that have evolved to being no different than banks or savings associations.
- The Office of Management and Budget has estimated that credit unions' tax exemption will cost the federal government \$8.06 billion for the five-year period ending in fiscal year 2013. ABA believes that the real cost to federal and state governments is much greater – somewhere in the range of an additional \$300 million per year. This loss of tax revenue at a time of dramatic federal and state deficits makes little sense.
- The Credit Union Membership Access Act of 1998 (CUMAA) imposed limits on business lending by credit unions. These limits affirm Congressional intent that credit unions maintain their focus on consumer lending, based upon fears that credit unions lacked expertise in commercial lending that could affect the overall safety and soundness of that industry, and upon concerns that expanding credit union powers would inappropriately extend their federal tax subsidy to these activities.
- Despite these limits, the National Credit Union Administration (NCUA) adopted a business loan rule in September 2003 that makes it easier for credit unions to engage in business lending. The rule authorizes credit union service organizations to engage in business loan origination; lifts the personal guarantee requirement for well-capitalized, well-managed credit unions; and authorizes well-capitalized credit unions to make unsecured member business loans within certain regulatory limits. Although the final rule scales back the scope of the original proposal and many of the modifications reflect

concerns expressed by ABA, banks, and the Treasury Department, ABA strongly opposes this rule because it contradicts Congressional intent to limit business lending by credit unions.

- Under CUMAA, Congress was clear in its preference to encourage the creation of new credit unions over the mere addition of new groups to ever-larger entities. The direct opposite has occurred, with large credit unions growing at an ever-increasing rate. Expanding consolidation flies in the face of Congressional intent. However, credit union trade associations and their regulator, the NCUA, continue to advocate changes that expand credit union membership options, facilitating this consolidation trend.
- The Government Accountability Office (GAO) released a study in November 2003 critical of several aspects of credit union regulation. Most significantly, the study notes that larger credit unions offer a wide range of services that closely resemble those offered by banks. A 2006 GAO study found that banks do a better job serve low- and moderate-income consumers than credit unions.
- As part of our commitment to ending NCUA's promotion of ever-larger credit unions at the expense of small, local financial institutions and taxpayers, ABA and the Utah Bankers Association (UBA) filed a joint lawsuit against NCUA in July 2003 that challenged the agency's approval of a six-county community common bond and the conversion of two large state credit unions to federal charters using the same geographic common bond. In December 2004, a federal judge sent the case back to NCUA for the agency to reconsider its decision. In December 2005, the NCUA withdrew its approval of the membership expansion for one of the credit unions at issue in the lawsuit, and in June 2006 limited the addition of underserved areas to multiple common bond credit unions.

Action

- The credit union industry continues to lobby Congress for such things as expanded commercial lending authority, broader membership powers, lower capital requirements, and increased capital-raising authority. ABA strongly opposes those efforts and encourages Congress to reexamine the tax-exempt status of those credit unions that have evolved to more closely resemble tax-exempt banks.
- Reps. Paul Kanjorski (D-PA) and Ed Royce (R-CA) introduced H.R. 1537, the Credit Union Regulatory Improvements Act (CURIA). The legislation would expand credit union commercial lending authority; undercut the regulation of capital levels; and impose more stringent voting requirements to make it more difficult for a credit union to convert to a mutual savings bank or savings association. ABA strongly opposes this bill, and will continue to oppose efforts to expand credit union lending authority.