Statement for the Record

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit
Of the

Committee on Financial Services

United States House of Representatives
The American Bankers Association (ABA) appreciates the opportunity to submit testimony for the record on the important subject of credit union charter enhancement. The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

The ABA opposes attempts to enhance the charter of credit unions as it would only further the competitiveness of a new breed of credit unions that seek to leverage their tax and regulatory advantages to grow quickly at the expense of taxpaying financial institutions. In particular, we oppose H.R. 3579, “The Credit Union Regulatory Improvements Act of 2003,” introduced by Representatives Ed Royce (R-CA) and Paul Kanjorski (D-PA), which would, among other things, greatly expand credit union commercial lending authority while at the same time undercut the regulation of capital levels at federally-insured credit unions. These changes would fuel even more aggressive growth within an ever-increasing segment of the credit union industry comprised of credit unions that are already indistinguishable from commercial banks. If credit unions desire to expand their scope of operations, such authorities are available today through conversion to mutual savings bank charters – a route that some credit unions have already taken.

This statement expands upon three central points:
A new breed of credit unions has emerged that offer products and services virtually indistinguishable from banks. These “morphed” credit unions are a far cry from traditional credit unions. Fairness dictates equal tax and regulatory treatment for similarly situated institutions, such as banks and these credit unions.

H.R. 3579 dramatically expands credit union business lending, shifting focus away from “people of small means.” There is already plenty of evidence that business lending by credit unions is often focused on larger loans to businesses that do not deserve tax-subsidized loans.

H.R. 3579 raises serious safety and soundness issues. The bill, by changing the definition of the net worth ratio, would artificially inflate the capital cushion purported to be available. Anecdotal evidence also suggests credit union business lending is occurring without the typical abundance of caution necessary with such high-risk and large-dollar lending.

A New Breed of Credit Unions has Emerged

As the credit union industry has matured, a new breed of institution has evolved that bears little resemblance to a traditional credit union. With the freedom to seek new markets virtually without restriction and to offer a full range of banking and financial products, many aggressive credit unions have leveraged their tax advantage to grow rapidly. During the past decade, credit unions over $500 million have grown their share of industry assets from 15 percent to 46 percent. Today, there are 89 credit unions with assets greater than $1 billion. In nearly half the states in this country, a credit union would rank among the top ten banks. As Gene Poitras, President of the Credit Union Association of Oregon, stated: “In a lot of places, credit unions are the major financial institution.”

These large, aggressive institutions increasingly dominate the industry, yet many still try to hide behind the veil of a “traditional credit union.” In spite of their metamorphosis into highly competitive financial institutions virtually indistinguishable from banks, these morphed credit unions enjoy the tax-preferred status conferred on the industry when it was composed of small self-help organizations.

Large Credit Unions are Increasingly Dominating Industry Share
(Based on Credit Unions Total Assets)

1991
- <$100: 15%
- $100-$200: 18%
- $200 - $300: 16%
- >$500: 16%

2003
- <$100: 12%
- $100-$200: 46%
- $200 - $300: 19%
- >$500: 23%

(Assets in $ millions)

The morphed credit unions offer a full range of products and services, including business loans, trust and asset management services, investment products, auto lending, credit cards, and home mortgages. Some offer securities, real estate brokerage, and/or insurance – even pet insurance! Many offer cutting edge technology, including Internet banking and smart cards. Tony Plath, professor of finance at UNC-Charlotte, summed it up: “I see very little difference between a regional bank and a large credit union.”

The General Accounting Office (GAO) confirmed this conclusion, adding that industry consolidation has widened the gap between large and small credit unions. Larger credit unions – those with assets of more than $100 million – offered more services than smaller credit unions. “Larger credit unions … tended to be more likely to provide more sophisticated services, such as financial services through the Internet and electronic applications for new loans.” The Congressional Budget Office (CBO) found the same thing: “Credit unions provide many of the same services that other thrift institutions [savings and loan associations and mutual savings banks] offer, including car loans, direct deposit, access to automatic tellers, preauthorized payments, credit cards, individual retirement accounts, safe deposit boxes, and discount brokerage services. Some large credit unions also offer electronic access to accounts as well as business loans.”

Norman D’Amours, former head of the National Credit Union Administration, summed it up in testimony before this very body: “In my view, credit unionism in the United States seems to be drifting towards becoming a not-for-profit banking sector. Institutions that are virtually indistinguishable from mutual banks.”

Under the guise of regulatory relief, the new breed of credit unions continues to push for charter enhancements while retaining their tax and regulatory benefits. H.R. 3579 is one such vehicle for credit union charter expansion. Fairness dictates equal tax and regulatory treatment for similarly situated institutions, such as banks and these “morphed” credit unions. Thus, no consideration of expanding the credit union charter should be undertaken without simultaneously equalizing the tax and regulatory treatment between banks and this new breed of credit unions. Simply put, if there is no practical difference between morphed credit unions and other financial services providers – either in the products they provide or whom they serve – preferential tax and regulatory treatment is not justified. Importantly, the mutual savings bank charter option exists today – **without the need for legislation** – for credit unions desiring to expand their scope of operations. This structure would allow these organizations to retain their cooperative structure.

---

4 Ibid, p. 16.
5 Norman D’Amours, *Congressional Record* H1882, 4/1/98
H.R. 3579 Dramatically Expands Credit Union Business Lending, Shifting Focus Away From “People of Small Means”

This new breed of credit unions is aggressively entering business lending. Their current tax-exempt status and lack of equivalent regulation have created huge competitive inequities in the local marketplace. Unfortunately, H.R. 3579 would further exacerbate these competitive inequities, as well as raise safety and soundness concerns.

Specifically, the bill would increase credit unions’ business lending authority to 20 percent of total assets. In addition, the bill excludes business loans under $100,000 from the business lending limit, up from $50,000 under current law, further masking the true amount of commercial lending engaged in by credit unions. *Taken together these changes would grant credit unions more expansive commercial lending authority than tax-paying federal savings associations*, which are subject to a flat 20 percent of total assets limitation, but do not have the benefit of excluding certain loan amounts from that cap.

The current limits, as stated in the Senate Report to the implementing Credit Union Membership Access Act of 1998, “…are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, through the emphasis on consumer rather than business loans.” How many loans to low- and moderate-income individuals could be made instead of 20 percent of all assets being devoted to business loans in excess of $100,000? Simply put, the focus on “people of small means” that was clearly enunciated in the preamble to the Federal Credit Union Act would be even further diminished – but the tax exemption for credit unions would not.

There is already plenty of evidence that business lending by credit unions is often focused on larger loans to businesses that do not deserve tax-subsidized loans:

- Less than one year after commencing operations, CU Business Group, LLC (a consortium of four large corporate credit unions) said it has processed more than $50 million in credit union business loans – with the average-sized loan over $600,000.

---

The average business loan made at California’s Arrowhead Credit Union is $225,000; at Telesis Credit Union, it is $783,000.

Coastal Federal Credit Union (NC) with $1.33 billion in assets advertises on its web site that business loans are available up to $2 million – hardly a micro loan.

OmniAmerican CU (TX) has established a $10.5 million line of credit and $2 million for working capital to Wide Open Spaces LLC for a real estate development project.

Whitefish Credit Union (MT) made a $7 million loan to Clark Fork Valley Memorial Hospital to finance the expansion of the hospital's services and facilities.

Citizens Equity First Credit Union located in Illinois made a commitment to finance a $2.6 million loan to Stonebridge Hospitality for a property located in South Carolina.

These are loans for which any bank would compete. But the tax advantages enjoyed by credit unions makes competition extremely difficult. A recent study by Virginia Commonwealth University professors Neil Murphy and Dennis O'Toole found that “…credit unions are enabled to offer a 67 basis point advantage in loan pricing and deposit pricing over banks as a direct result of the fact that credit unions do not pay state or federal taxes.” The professors conclude: “In a highly competitive industry, the sixty-seven basis point government subsidy is substantial.” The Federal Reserve Bank of Dallas agreed with the competitive threat: “Credit unions, aided by favorable legislation and regulation, have emerged as another particularly severe threat to small banks.”

**H.R. 3579 Raises Serious Safety and Soundness Issues**

But the credit union story does not stop here – the safety and soundness of these business loans is an open question. A Pennsylvania banker reports losing a $2 million shopping center loan to $1.4 billion Visions FCU (NY). The reason: the bank wanted covenants in place to protect itself against an anchor store owned by a company in bankruptcy – the credit union did not seek the added protection and made the loan at a lower rate.

---


A community banker in Montana reported discussing a 2004 renewal of an operating line of credit of $180,000 (with total debt of $279,000) with a farmer/rancher. The operation was not cash flowing and, after operational changes were discussed and a second mortgage agreed to on his real estate, the bank committed to 2004 financing. The borrower went to a local credit union to inquire about agricultural loans – the credit union paid the bank debt off without asking the bank for any of the borrower’s financial information, funded the loan and commitment without real estate as collateral, all at an interest rate lower than the risk-based rate the bank would have charged. Simply put, the credit union booked a high-risk loan at a reduced rate without sufficient collateral.

Congress worried about credit union risk taking on business lending – an activity typically much riskier and involving larger dollars than consumer lending. As a result, Congress put in place the current limitations, noting: “The Committee action will prevent significant amounts of credit union resources from being allocated to large commercial loans that may present additional safety and soundness concerns for credit unions and that could potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund.”

By raising the exclusion for business loans to $100,000, H.R. 3579 encourages more lending at much larger dollar volumes and it would allow even more loans to be exempt from the special regulatory requirements for business lending, such as loan-to-value limitations and using experienced business-loan officers.

To make matters worse, H.R. 3579 would weaken capital standards by changing the definition of net worth ratio in a manner that would artificially inflate the capital cushion purported to be available to absorb losses. It does so by eliminating the minimum capital “leverage ratio” requirement. The current capital system was developed by Congress in 1998 because, in the words of the Treasury Department during the debate on the bill, NCUA’s “…relevant statutes, regulations, and policies fall short of providing a system of prompt corrective action for credit unions. The NCUA has no regulations or even formal guidelines for taking corrective action regarding a troubled credit union…” Moreover, the current capital rules were specifically imposed by Congress in order that credit unions would have the same type of capital requirements that were given to commercial banks and savings institutions in the aftermath of the savings and loan crisis.

9 Ibid.
10 Credit Unions, United States Department of the Treasury, 1997, p. 76
To remove the leverage ratio requirement would be to forget the lessons of the savings and loan crisis about the importance of a minimum mandatory capital requirement.

In sum, expanding commercial lending powers for credit unions, while simultaneously reducing capital levels, raises significant safety and soundness concerns. Moreover, the credit union lobby’s efforts to obtain such expanded authority will primarily benefit the new breed of credit unions that are indistinguishable from banks and a far cry from traditional credit unions. The reality is that these morphed credit unions have out-grown their tax-exempt status and should be treated like any other full service financial services provider, including subjecting such institutions to taxation and bank-like regulation. The mutual savings bank option exists today for those credit unions that wish to expand their scope of operations and still maintain their cooperative structure. Thus, there is no need for legislation expanding the scope of credit union operations.

For these reasons, we oppose H.R. 3579. The American Bankers Association appreciates the opportunity to express the views of the banking industry on this important issue.