Kansas Credit Union Association

Testimony of Marla S. Marsh
On behalf of the
Kansas Credit Union Association

Before the
Subcommittee on Oversight and Investigations
of the
Committee on Financial Services
United States House of Representatives Field Hearing
August 23, 2010

"Too Big Has Failed:
Learning from Midwest Banks and Credit Unions"

Chairman Moore, Ranking Member Biggert, and Members of the Subcommittee:

I appreciate the opportunity to appear today before the sub-committee on behalf of the Kansas Credit Union Association to speak to the lessons that Wall Street can learn from Kansas credit unions. The 103 Kansas credit unions are not-for-profit financial cooperatives whose purpose is to serve the financial needs of their 590,000+ member/owners. My experiences over the past 14 years as President/CEO of KCUA along with my years working with credit union trade associations in Ohio, Illinois, and New York and serving on the Board of Directors for the Credit Union National Association give me a wide perspective of the credit union industry.

To say that the past 24 months have been tumultuous for the financial services industry would be an understatement. Undoubtedly, there is much that has gone wrong and many risky practices undertaken by certain players in the financial services marketplace that have contributed largely to the Great Recession. In the ensuing months, there has been a heavy focus on what went wrong and what the government needs to do to prevent such systemic failures in the future. However, it would be shortsighted of us to ignore the players and practices that did not contribute to the recession and are helping to restore economic stability. There is much that can be learned from credit unions—both in Kansas and across the nation—with their founding philosophy and continued commitment to putting people before profit.

Kansas Credit Unions: Strong Before and After the Recession
To understand the impact of the recession on the credit union industry, it is helpful to have a perspective of the effects of the recession on the Kansas economy. In general, Kansas has fared better on many economic indicators than our peers on the coasts. Kansas did not see the dramatic boom that other areas of the country experienced leading up to the recession and, consequently, we have not seen the bust to the same degree that other states have. For example, according to the Federal Housing Finance Agency, home prices on conforming home loans in

Kansas are currently down just -2.6% from their peak whereas nationally home prices have declined -13.2% from their mid-year 2007 peak. Moreover, the Bureau of Labor Statistics reports that the state's 6.5% June 2010 unemployment rate is three percentage points lower than the 9.5% national average. Still, the landscape differs significantly based on location: the unemployment rate in both Dodge City and Leawood is now 4.2% but it is 9.8% in Leavenworth and 10.4% in Kansas City.

In general, however, Midwest values, both personal and commercial, support what some might consider a conservative viewpoint but we would say reflects a more calculated risk analysis process that produces a balanced approach to growth and innovation. Although the Kansas economy may not have had the precipitous and rapid decline faced by other states, the Kansas economy has felt and continues to feel the effects of actions by those who either were less cautious or were greedily proceeding without heeding the warning signs.

Similarly, while Kansas credit unions today are generally healthy and well capitalized, they have not been immune from the effects of the downturn. Kansas credit union loan loss rates have more than doubled during the recession from 0.53% in 2006 to 1.30% in the year ending March 2010. Kansas credit union capital ratios declined from 12.6% at the end of 2006 to 10.8% at the end of March 2010.

Yet compared to their credit union and bank peers Kansas credit unions stand out.

In the year ending March 2010, Kansas credit unions continued their trend of asset growth reporting a 6.5% increase in assets. In the same period, U.S. credit union assets increased by 4.7% while Kansas banking institution assets declined by -0.4% and U.S. banking institution assets declined by -1.3%. The trend of sizeable asset growth over the past 12 to 18 months reflects a flight to safety by consumers as they curbed spending to build their savings or transferred Wall Street investments to local institutions. It is also a demonstration of continued consumer confidence in Kansas credit unions as trusted financial partners. This trend of turning to community financial institutions has been seen in broader, national movements, such as movemymoney.org, that encourage consumers to utilize local financial institutions. In addition to asset growth, the pace of lending in Kansas credit unions remains strong. In the year ending March 2010, Kansas credit union loans grew by 5.7%. During the same period Kansas banking institution loans declined by -7.3% and U.S. bank loans declined by -3.0%.

And while it is true that Kansas credit union capital ratios and asset quality has declined the deterioration has been less pronounced than what has been experienced by others. At the end of the first quarter 2010, the Kansas credit union 10.8% average net worth-to-asset ratio compares favorably with the 9.9% national credit union norm and the 10.1% Kansas bank average. Kansas credit union asset quality has deteriorated but the 60+ day dollar delinquency rate stood at 1.30% at the end of March - marginally lower than the 1.77% national credit union average and substantially lower than the 90+ day dollar delinquency rate at both Kansas banks (3.39%) and banking institutions throughout the nation (5.50%). Similarly, since the start of the recession, Kansas credit union net chageoffs averaged 0.93% of average loans – lower than the U.S. credit union average (1.08%), and lower than both the Kansas bank average (1.01%) and the U.S. banking institution average (2.33%).

At the end of 2008, there were 108 Kansas credit unions—85 state chartered and 23 federally chartered. Today, the number has decreased to 103—82 state chartered and 21 federally chartered. It is important to note that this trend is not a direct result of the economic recession. Rather, it is a continuation of a 10 year trend of declining numbers of credit unions, ranging from 3 to 5 credit union consolidations per year. This decrease can be attributed to a number of factors including the increasing complexity of the financial services marketplace, the ever increasing cost of technological changes, and onerous compliance and regulatory burdens faced by small to mid-sized financial institutions. We hope that the Committee will be mindful of and will monitor how the new Dodd/Frank law is implemented, including the overall impact new and current regulations will have on the operations of these institutions.

The Dodd/Frank law has addressed some of the issues surrounding the "too big to fail" financial institutions. No credit union or group of credit unions is large enough to negatively impact the entire financial system. Failures of credit unions would be contained within the credit unions system itself. The National Credit Union Administration (NCUA), as regulator of federally chartered credit unions and insurer, has worked in concert with state regulators and the Administration to actively address any systemic risk that would impact the credit union system. In September, NCUA is scheduled to release new regulations on the structure of the Corporate Credit Union Network and legacy assets held by some of the corporate credit unions (which function like bankers' banks providing correspondent services to retail, natural person credit unions).

The greatest risk for credit unions comes from the collateral damage caused by the "too big to fail" institutions. The devaluing of property, the decrease in consumer confidence and spending, the failure of support organizations, the increase in unemployment contribute to a strain on the financial well being of our member/owners and in turn force adjustment to credit union operations. The second and equally damaging impact of "too big to fail" is the rise in regulatory burden and examiner "one size fits all" approach that stifles our efforts to do what we do best—provide solutions to meet the financial needs of our members and help grow local economies.

Lessons to be Learned from Kansas Credit Unions

As the data demonstrate, Kansas credit unions are faring well compared to their peers in the financial services industry nationwide and particularly their peers on Wall Street. This is the result of time tested, prudent business practices that have served Kansas consumers well through many adverse situations. There are a number of lessons to be learned from the Kansas credit union industry.

The key lesson, in a nutshell, is that relationships matter. The biggest difference between the Wall Street business model and the credit union business model is the member ownership component. When the institution is owned by the "customer", there is mutual responsibility to act in the best interest of each party. Every decision made at a credit union is driven by the focus on bettering the members and the financial institution they co-own, while a for-profit entity's primary focus is on driving the bottom-line return back to their owners, whether that is one individual or family or a large and diverse group of stockholders. While capitalism is a primary element of business in this entire country, the focus on return to owners by some large financial firms and institutions certainly contributed to excessive risk taking, confident that they would be considered too big to fail if things didn't work out.

Credit unions recognize that to protect the interests of their member/owners they need to be partners with their members. Credit unions are closer to the end user than large Wall Street institutions that caused the crisis. Credit unions still adhere to lending principles that consider more than just a credit score or collateral, but also weigh the character and personal capacity of the borrower to handle the terms of the loan. The large degree of separation from decision-maker to end user (borrower) seen in large financial firms encourages an internal institution focus and risky behaviors to increase profits. There is no incentive for credit unions or their employees to offer products that will harm their member/owners, unlike the enormous Wall Street incentives paid on future performance that can be harmful to the end user—the consumer.

In addition to this close relationship to their member/owners and a focus on making decisions that are in the mutual best interest of both parties, credit unions have solid underwriting processes and hold most of their loans on their books. Having skin in the game results in financial institutions that care about whether the loans are successfully paid back. In the sub-prime mortgage crisis we saw what can happen when lenders loan irresponsibly knowing that the loans will be passed down the line and become someone else's problem. Another benefit is that credit union decision makers live and work in the communities alongside their members. Knowledge of local and state economy provides insight into potential risk and at the same time allows us to identify how we can best help our members with appropriate products and services.

The focus on working with members in the interest of maintaining a strong and secure institution for all is what credit unions have done for decades. The credit union movement in the United States started to flourish during the Great Depression as consumers created opportunities for savings and lending by pooling their money. Then, as today, credit unions provided another avenue for consumers and businesses to access credit and cooperatively benefit from sound thrift principles. The importance of having local, safe, and reliable alternatives to the Wall Street firms cannot be overstressed. Credit unions today, as they have everyday and in every economic downturn, provide options for their members to cope and deal with the hardships.

Conclusions: Moving Forward

Moving forward credit unions have a strong role to play in the financial services marketplace. Though we are a small portion of the overall marketplace, the need for sound alternatives to the for-profit banking industry still exists today. As Congress continues to address the lingering effects of the recession and prevent future abuses, we urge Congress to recognize the challenges faced by credit unions as they address increasing compliance burdens. Though credit unions did not cause this recession, they face steep costs associated with complying with regulations targeted at the abuses that occurred at Wall Street firms. The regulatory burden is making it increasingly difficult for small institutions to mid-size institutions to compete in this economy.

We also urge Congress to continue to allow flexibility and increase options for credit unions to continue to serve their members and put much needed capital back into their local economies. For example, Congress could help create hundreds of jobs and make thousands of dollars of capital available to Kansas small businesses with zero expense to taxpayers by increasing the statutory credit union member business lending cap. Representatives Paul Kanjorski and Ed Royce have introduced bi-partisan legislation which would increase this cap from 12.25% of total assets to 25%. Similar legislation has been introduced in the Senate by Senator Mark Udall. Senator Udall's bill would increase the cap to 27.5% of total assets and includes safeguards to ensure that increased business lending is done in a prudent and gradual manner, further protecting the National Credit Union Share Insurance Fund. This legislation was developed in conjunction with the Administration, and it enjoys the Administration's support. We encourage Congress to enact this no-cost to the taxpayers job creation measure as soon as possible.

Credit unions in Kansas today continue to do business as usual. Their mission in both the pre and post crisis economy is to serve their members in a way that puts members before profit. On behalf of the 103 credit unions in Kansas, I thank you for allowing the Kansas Credit Union Association the opportunity to testify on this important topic.