CUNA
Credit Union National Association
601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | PHONE: 202-638-5777 | FAX: 202-638-7734
cuna.org

TESTIMONY
OF
JEFF YORK
PRESIDENT AND CHIEF EXECUTIVE OFFICER
COASTHILLS FEDERAL CREDIT UNION

ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

LEGISLATIVE HEARING ON

H.R. 1418
THE SMALL BUSINESS LENDING ENHANCEMENT ACT

OCTOBER 12, 2011

Testimony
of
Jeff York
President and Chief Executive Officer
Coasthills Federal Credit Union
on behalf of the
Credit Union National Association
Before the
House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Legislative Hearing on
H.R. 1418
The Small Business Lending Enhancement Act
October 12, 2011

Chairman Capito, Ranking Member Maloney, Members of the Subcommittee:

Thank you very much for holding today's hearing on credit union member business lending and inviting me to testify on behalf of the Credit Union National Association (CUNA).[1] My name is Jeff York, and I am president and Chief Executive Officer of Coasthills Federal Credit Union in Lompoc, California.[2] I am a member of CUNA's Board of Directors.

I have been asked to present our views on H.R. 1418, the Small Business Lending Enhancement Act. Simply put: credit unions strongly support this legislation and encourage Congress to pass it as soon as possible. Enactment of H.R. 1418 would permit credit unions to lend an additional $13 billion to small business-owning credit union members in the first year, helping them create 140,000 new jobs without an outlay of taxpayer money. This is bi-partisan

[1] Credit Union National Association is the largest credit union advocacy organization in the United States, representing nearly 90% of America's 7,500 state and federally chartered credit unions and their 93 million members.
[2] Coasthills Federal Credit Union serves the financial needs of 62,000 members living in San Luis Obispo and Santa Barbara Counties in California. The credit union had total assets of $620 million, as of June 30, 2011.

job creation legislation that can contribute to economic recovery. Failure to pass this legislation will mean these jobs will not be created – at a time when our nation is desperate for new jobs.

My testimony discusses the need for additional business lending in today's economy; describes H.R. 1418 which has been introduced by Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY) and endorsed by the Administration, to provide certain credit unions with the authority to make additional member business loans(MBL); explains the methods behind CUNA's estimate of additional business lending and job creation as a result of H.R. 1418; and, responds to the objections to this legislation raised by the banking trade associations – the only group we know of that is opposed to helping small businesses by raising the MBL cap.

The Need to Increase Access to Small Business Credit

We all have been affected in one way or another by the recession and nearly everyone knows someone who has been seriously affected. The stock market has only partly recovered. Unemployment is persistently too high. One in six households is currently affected by unemployment or underemployment. Banks have pulled back access to credit. Small businesses are being hit hard. And, as the debate drags on over how to fix the problems facing our economy and our country, many Americans are frustrated by programs that do not live up to their potential and showdowns that bring the government to the brink of shutdown.

Despite the difficulties of the last several years, credit unions like mine have been there for our members. We worked with members during the housing crisis. We have been there for members when they were laid off. Credit unions have been on the front lines of this recession doing everything they can to help their members through refinancing and restructuring debt, offering favorable rates on our financial products, tailoring programs, offering financial counseling and other services -- and we want to do even more.

I think there is one thing that Democrats and Republicans alike can agree on: too many Americans need jobs. Economists and other experts agree that small businesses are a driving force in producing new jobs. Small business-owning credit union members are no exception and they want to create jobs. To do that, they need a financial partner who will stand with them and help their business succeed with credit when they need it and support for their payrolls and other aspects of their operations. Many are not finding the support they need from banks. And, regrettably, if Congress does not act, it will be increasingly difficult to find that support from credit unions. That is because of the statutory cap on credit union business lending enacted in 1998 as part of, ironically, a bill called the Credit Union Membership Access Act.

The Pepperdine Capital Markets Project has recently been conducting a survey of U.S. small businesses in conjunction with Dunn and Bradstreet. Data collected during the week of August 29, 2011, from a sample of over 5,500 U.S. small business owners finds that nearly one-quarter sought a bank loan in the preceding 12 month period. Among those that sought bank financing, 57% indicated that they were not successful in obtaining financing. This is one more clear indication that a substantial number of small businesses continue to need more access to capital.[3]

Not surprisingly, a large number of small business owners are telling policymakers that they are being turned away by their banks. I have heard this from small businesses in my area, like the owners of SLO Gas & Mart locations throughout Santa Barbara and San Luis Obispo County, to whom we granted a business loan in September 2009. These members were unable to secure credit from their bank. They came to the credit union. We loaned them the money they needed, and this loan helped them create 15 jobs.

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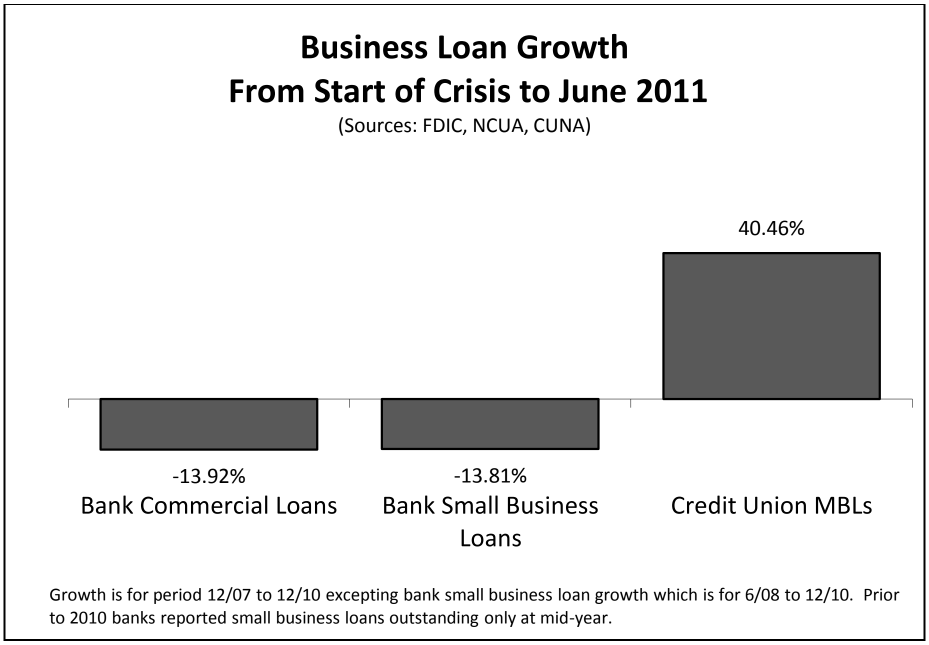
[3] See: http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey. Survey of firms with less than $5 million in annual revenues.

This example is not an isolated incident. It is a refrain repeated across the country, which is why Congress has held several hearings on small business access to credit over the past several years, and one of the reasons that Congress last year enacted the Small Business Lending Fund Act.

Recent data from financial institution regulatory reports to the federal government also demonstrate that banks – both large and small – are turning away many business borrowers. In the year ending June 2011, community bank commercial loans outstanding declined by 2.6% in sharp contrast to the 4.4% increase in credit union business loans over the same period.[4]

This is not just a short-term trend. As shown in the following graph, since the beginning of the recession three and a half years ago, total bank business loan portfolios have declined by almost 14%, while credit union business loan portfolios grew at a healthy rate of over 40% – a very stark difference. If indeed the contraction in business credit outstanding was due solely to reduced demand, credit union business lending would have declined as it has at banks. That is obviously not the case. **However, this strong growth, and the support it provides to America's small businesses cannot continue into the future unless Congress raises the credit union business lending cap.** As I will describe later, it is exactly because of this very strong recent business lending that more and more credit unions are getting uncomfortably close to the cap.

[4] Community banks are here defined as those with $10 billion or less in total assets. Data is from FDIC and NCUA Call Report filings.



Recent academic research underlines the role of credit unions as a counter-cyclical presence in the marketplace. In a Small Business Administration (SBA) report published last month, Professor James A. Wilcox of the University of California finds that small business loans (SBLs) at credit unions "tended to partially offset declines in business loans at banks. Credit unions' increasing share of SBLs and the estimated offsets suggest that credit unions are increasingly important sources of SBLs as a longer-run development and in response to fluctuations in SBLs at banks."[5]

All this data make it clear: allowing credit unions to extend loans to businesses that need credit will add fuel to help create a self-sustaining economic expansion. Increasing competition in the small business loan market will increase the efficiency of capital allocation. Businesses will generally choose the loan products and other services that provide them the best overall

[5] James A. Wilcox. *The Increasing Importance of Credit Unions in Small Business Lending.* SBA Office of Advocacy. Release Date: September 2011.

value. And credit union competition will ensure that banks are treating their small business customers more fairly.

For the past several years, business loans have been the fastest growing component of credit union lending. From June 2001 to June 2011, business loans at credit unions grew at an annual rate of 22.3%, over three times faster than the 6.4% annual growth rate of all credit union loans. However, that growth is now slowing as more and more credit unions approach their caps. A credit union cannot simply lend up to the cap and then halt lending. The closer a credit union gets to its cap, the less accommodative it can be in granting new business loans. This is necessary to be able to meet continuing and additional credit needs of existing business borrowing members.

Increasing the credit union member business lending cap is a critical issue for Coasthills and many other credit unions that are at the cap or nearing the cap. We have to manage to the cap well before we reach the 12.25% of assets level. Business services (lending) is at the core of my credit union's plan to serve its communities. Our business loan portfolio is currently about 7% of assets. Banks might suggest that means I am unaffected by the cap. Let me assure you that we are heavily affected by the cap.

Coasthills could hit the cap in six months if I thought that would make sense for our business. We have discussions about our cap limitations during every budget meeting and at most asset and liability committee meetings.

Demand for business credit is high in our market. And, there are very few community and conglomerate banks making loans in our area. Several of the community banks in our area are under regulatory restrictions from the Federal Deposit Insurance Corporation (FDIC) or the California Department of Financial Institutions which has prevented them from extending new credit and required them to raise capital. The result has been several mergers in the last 18 months, which is not typically a good thing for business borrowers of the merged institutions. There are 25 banking institutions with 182 branches operating in the counties where my credit union has a branch presence. The FDIC does not publish branch-level data on these institutions, however, assuming a proportional distribution of small business loans by branch we find that these institutions had a 6.1% decline in small business loans in the twelve months ending June 2011. In dollar terms, that works out to a prorated decline of $97 million in bank small business loans over the course of the past year in the area where I do business.

The local economy around my credit union has been really hit hard by the financial crisis. Towns such Lompoc and Santa Maria have seen unemployment over 20% and home prices fall more than 70%. Small businesses in this market need credit to get back on their feet. There is absolutely no public policy reason to limit my credit union's ability to provide that credit.

We have a real opportunity to serve our business-owning members because we are well capitalized and we have the liquidity to lend. However, we keep our business lending portfolio at just above 50% of the cap on purpose despite the fact that we have plenty of demand because it does not make sense for us to ramp up our business services area just to have to close it down within a few months. This is the dilemma facing many credit unions engaged in business lending. Credit unions which contemplate, but do not yet offer, business services face a similar dilemma: why get into the business at all when the cap can be reached in a relatively short amount of time?

Credit unions have continued providing loans while other lenders have run to the sidelines. However, the credit unions responsible for most of the recent growth in credit union business lending are of course likely to be either at the cap or approaching it quickly. To keep the most experienced business lending credit unions in the game serving their small business members, it is imperative that Congress respond to the needs of small businesses for credit and permit credit unions greater authority to meet those needs. In fact, without an increase in the cap, the recent strong growth in credit union lending to small businesses will have to slow to a trickle.

H.R. 1418 – The Small Business Lending Enhancement Act

H.R. 1418, which has been introduced by Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY) and cosponsored by over 85 members of the House of Representatives, would give qualifying credit unions as determined by their prudential regulator the ability to lend in excess of the current statutory business lending cap of 12.25%, up to 27.5% of total assets.[6] The Royce-McCarthy bill is a jobs bill that would not require any appropriation of taxpayer money. It has received strong support of the Administration, and the U.S. Department of the Treasury worked with the National Credit Union Administration in the development of the legislation.[7]

The Royce-McCarthy bill establishes a two-tier structure for the credit union member business lending cap. Tier One credit unions would remain under the current business lending up to 12.25% of their total assets. Tier Two credit unions would have to meet additional statutory and regulatory criteria and be approved by NCUA. On a case-by-case basis, they would then be permitted to engage in business lending up to 27.5% of their total assets. The legislation would require that in order for a credit union to achieve Tier Two status, it would have to:

[6] Senators Mark Udall, Olympia Snowe and Charles Schumer have introduced companion legislation (S. 509) in the Senate. This legislation is cosponsored by twenty Senators.
[7] Letter from Treasury Secretary Timothy Geithner to House Financial Services Committee Chairman Barney Frank regarding credit union member business lending. May 25, 2010.
http://www.cuna.org/download/mbl/geithnerltrto_frank0810.pdf

- be well-capitalized (currently, 7% net worth ratio);
- be at or above 80% of the Tier One cap for one year prior to applying for approval;
- have engaged in member business lending for five years prior to applying; and,
- demonstrate to the regulator sound underwriting and servicing based on historical performance, strong management, adequate capacity to lend, and policies to help manage increased business lending successfully.

Tier Two credit unions would be permitted to increase their business lending in a measured way. A Tier Two credit union's business lending portfolio growth could be no more than 30% per year, a rate that NCUA and the U.S. Treasury support as prudent. NCUA would be required to apply the above regulatory standards when considering a credit union for Tier Two status. Additionally, a credit union that drops below the well-capitalized level would have to stop making new business loans until such time as NCUA determines it is again well-capitalized.

The legislation makes no change to the definition of a business loan, preserving, but not increasing, the current $50,000 *de minimus* threshold. Finally, H.R. 1418 directs NCUA and the Government Accountability Office to conduct separate studies of credit union business lending and report to Congress three years after enactment.

In short, H.R. 1418 would permit credit unions with the most experience successfully offering business loans to their members the opportunity to continue to do so as they approach the cap, while at the same time ensuring that these credit unions engaged in additional business lending continue to do so safely and soundly.

As noted above, we estimate that if this proposal were enacted into law, credit unions could lend billions more to small businesses in the first year after implementation, helping small businesses create well in excess of 140,000 new jobs. In the districts of the members of this subcommittee, this legislation would result in almost a $1 billion in new lending, creating nearly 9,000 new jobs. **This is a job creation proposal that would not cost the taxpayers a dime and would not increase the size of government.**

This legislation is not a panacea for the economic problems we face, but it will help small businesses. That is why over twenty-five small business and public policy groups have signed an open letter urging Congress to enact the Royce-McCarthy bill, including: the Americans for Tax Reform, the Progressive Policy Institute, Competitive Enterprise Institute, Ford Motor Minority Dealer Association, Hardwood Foundation, Freedom Action, AMT – The Association for Manufacturing Technology, League of United Latin American Citizens (LULAC), American Consumer Institute, National Association of Mortgage Brokers, National Cooperative Business Association, National Farmers Union, National Small Business Association, National Cooperative Grocers Association, NCB Capital Impact, National Association of Professional Insurance Agents, National Association for the Self-Employed, National Council of Textile Organizations, National Association of Realtors®, Certified Commercial Investment Member (CCIM) Institute, Institute of Real Estate Management, Realtors® Land Institute, the Society of Industrial and Office Realtors®, Multifunding, Council for Insurance Agents and Brokers, Center on Risk, Regulation and Markets at the Heartland Institute, and the Small Business Majority.

Estimate of Additional Small Business Lending and Job Creation Resulting from H.R. 1418

Relaxation of artificial statutory lending restrictions will increase the efficiency of capital allocation in the economy by removing an arbitrary restriction on an important source of credit. This will promote more lending, more spending, more job creation and higher economic growth. Recent bank business loan contraction suggests that, at least to some degree, if the legislation is passed that credit unions will be making loans that banks are not willing or able to make.

As indicated earlier in this statement, we estimate that raising the business lending cap would allow credit unions to increase business lending by up to $13 billion in the first year after the cap is lifted. This estimate is based on three **conservative** assumptions, which are described below:

1. We assume that "grandfathered" credit unions (i.e., the approximately 100 credit unions that are currently above the 12.25% cap because they already had substantial business loan portfolios when the cap was first imposed in 1998) do not increase their lending when the cap is raised.
2. We assume that credit unions that are not currently engaged in business lending would enter the market in an amount equal to 1% of total assets on average under the new authority. We further assume that only 40% of the increased activity would occur in the first year.
3. We assume that all other business lending credit unions will eventually lend in an amount equal to their current "use" rate, i.e., all non-grandfathered current business lending credit unions would eventually just over double their business lending. Our conservative estimate assumes that only 40% of the increased lending would occur in the first year.

Estimates produced using these three assumptions are further adjusted as follows:

- Credit unions with net worth/assets less than or equal to 6% are assumed to have no business loan growth;
- Credit unions with net worth/assets between 6% and 7% remain at the current 12.25% cap; and
- Credit unions with member business loans/assets greater than 10% are limited to a 30% increase in MBLs in the first year. (Tier Two Credit Unions)

Applying these assumptions produces an estimate of a $13.4 billion first-year increase in lending, which we have rounded down to $13 billion. That would represent an approximately 30% increase in credit union business lending. This is certainly plausible considering that credit union business loan portfolios increased by 30% or more in four of the past nine years. That growth has slowed recently as an increasing number of credit unions have begun to approach their caps.

Because many bank business loan portfolios are shrinking, we reasonably assume that the new loans would largely be loans that would not otherwise be made by banks. The expected increase in lending can be viewed as stimulus similar to direct government spending. Thus, we assume that the additional lending would produce jobs at a rate that is similar to the estimates published by the Council of Economic Advisors (CEA) in its May 2009 estimates of job creation.[8]

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[8] See: http://www.whitehouse.gov/administration/eop/cea/Estimate-of-Job-Creation/. Note: Use of Small Business Administration survey data would produce a much larger estimate of job creation. Since CUNA's aim was to produce a conservative estimate we chose not to use the SBA job creation data.

Using these assumptions and rounding, each $92,000 in additional MBL lending on the part of the nation's credit unions will create one additional job. Therefore, expanded credit union MBL authority will result in an estimated first-year increase of 146,000 new jobs nationally.

A recent report, compiled by David M. Smith, Associate Professor of Economics at Pepperdine University, finds that CUNA's assumptions and estimates outlined above are "conservative and well within the bounds of a reasonable projection."[9]

Addressing the Objections of the Banking Trade Associations

The only groups that are standing in opposition to this small business job creation legislation represent large and community banks, many of which received taxpayer bailouts but abandoned small businesses during the financial crisis. These groups represent banks that not only took taxpayer money from the Troubled Asset Relief Program (TARP), but then also applied taxpayer money made available through the Small Business Lending Fund (SBLF) Act to repay their TARP obligations, instead of putting that money to use to the benefit of the small businesses for which it was intended.[10] This is an outrageous abuse. Given the wholesale disregard by these banks for taxpayers and small businesses, it comes as no surprise that they would block legislation in Congress intended to help small businesses. In an effort to cement the strong public policy standing of this legislation, this testimony will address the several objections that they have raised.

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[9] David M. Smith. *Raising the Credit Union Member Business Lending Cap: Projected Labor Market Impact.* September 2, 2011. Summary results available through CUNA.
[10] "The Tale of Two Loan Programs." Wall Street Journal. October 6, 2011. C1.

The American Bankers Association (ABA) during its testimony before a Senate Banking Committee hearing focusing on the Senate version of the Royce-McCarthy legislation earlier this year suggested the following (emphasis in the original):

- "Raising the credit union legal business lending cap is ***not necessary*** for credit unions to meet small business members' credit needs."
- "Expanding the lending cap is ***inconsistent with the credit union mission*** of serving consumers, especially those of modest means."
- "Business lending is riskier and ***raises serious safety and soundness concerns.***"
- "There is a better option for credit unions that want to expand business lending – ***convert to a mutual bank charter.***"[11]

The Independent Community Bankers of America (ICBA) made similar suggestions in its testimony at the June 16, 2011, hearing, claiming that credit unions lack experience in commercial lending, that credit unions are not fulfilling their tax-exempt mission, and the credit union lending comes at a significant cost to taxpayers; ICBA also notes that credit unions could convert to the mutual thrift charter.[12] In an August 30, 2011, letter to President Obama the ICBA also claims that expanded business lending would displace community bank lending.[13]

These are the banks' arguments against the bill. We will address them individually.

The banks say that it is not necessary to raise the credit union business lending cap for credit unions to meet their members' small business credit needs. They also note that credit

[11] Testimony of Stephen P. Wilson on behalf of the American Bankers Association before the Senate Committee on Banking, Housing and Urban Affairs Hearing on Credit Union Member Business Lending. June 16, 2011. 5.
[12] Testimony of Noah Wilcox on behalf of the Independent Community Bankers of America before the Senate Committee on Banking, Housing and Urban Affairs Hearing on Credit Union Member Business Lending. June 16, 2011.
[13] Letter from Camden R. Fine to President Barack Obama. August 30, 2011. 2.

union member business loans under $50,000 are exempt from the cap, as are the guaranteed portion of Small Business Administration loans. They note that "only a few credit unions – 96 out of 7,292 credit unions – are within 80 percent of their congressionally-mandated cap."[14]

The notion that the cap affects a small number of credit unions represents a complete misunderstanding of how the cap functions, and limits credit union lending. Thousands of credit unions will be impacted because the cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but it also discourages credit unions from even entering the business lending market.

As of June 2011, there were 1,833 non-grandfathered, business lending federally insured credit unions without a low-income designation with $27.7 billion of business loans on their books. They are shown on the table below in terms of their proximity to the cap:

MBL Credit Union Profile
Data as of June 2011. Excluding Non-Grandfathered and Low Income CUs
Sources: NCUA and CUNA.

MBLs/Assets	# of CUs	Percent of These CUs with < $500 Mil. in Assets	Total MBLs (Billions)	Percent of Total Non-Grandfathered MBLs	Growth in MBLs in Year Ending June 2011	Estimated Average Number of Years to Reach Cap at Recent Growth Rates
>0% to 5.0% (not yet constrained)	1,309	87%	$7.06	25.5%	4.9%	> 5 years
5.0% to 7.5% (initial constraint)	227	71%	$6.52	23.5%	35.6%	2.7 years
7.5% to 10.0% (approaching the cap)	149	73%	$6.98	25.2%	23.0%	2.5 years
>10.0% to 15% (at the cap)	148	71%	$7.14	25.8%	-12.5%	< 1 year
Totals	**1,833**	**82%**	**$27.70**	**100.0%**	**8.5%**	

The following is how these various groups of credit unions are affected by their proximity to the cap, and the implications for future business lending by credit unions.

[14] Wilson. 6.

- A total of 227 credit unions hold business loans between 5% and 7.5% of assets. These credit unions will be capped within 2.7 years at recent growth rates. They held $6.5 billion in business loans at mid-year 2011 and their business loans grew by $3.9 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- Another 149 credit unions hold business loans between 7.5% and 10% of assets. These credit unions will be capped within 2.5 years at recent growth rates. They held $7.0 billion in business loans at mid-year 2011, and their business loans grew by $2.1 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- 148 credit unions, with $7.1 billion in business loans outstanding, had business loans of more than 10% of assets. These credit unions are essentially capped or will reach the cap in the next twelve months. In the three years ending June 2011, business loans outstanding at these credit unions rose by only $137 million. They will be able to contribute very little to future business loan growth without an increase in the cap.

Taken together these 524 credit unions now account for 75% of all business loans subject to the 12.25% cap. These credit unions have been the major contributors to credit union business loan growth over the past few years – accounting for 83% of total growth in non-grandfathered credit unions.

When the business lending growth of these credit union is contrasted, the hindrance of the cap is clearly seen. Credit unions with 5% to 7.5% MBL/Asset ratios saw portfolios increase by 36% in the year ending June 2011; credit unions with 7.5% to 10% MBL/Asset ratios experienced an increase of 23%. Credit unions with more than 10% MBL/Asset ratios actually saw their loan portfolios decline. These credit unions will be able to contribute very little to future business loan growth without an increase in the cap.

Over the next few years, the business loan growth of this group of more than 600 credit unions will dry up without an increase in the cap. In other words, the banks may claim that only 171 credit unions (or fewer) are actually capped, but as we have seen, another 432 are right behind them, and will bump up against the cap in the next one, two or three years. Because of that, most of these credit unions are already looking for ways to moderate their business loan growth.

Both the number of credit unions approaching the cap and the total amount of non-grandfathered MBLs held by these credit unions has increased dramatically in the past ten years: Ten years ago, only 10% of non-grandfathered MBL credit unions were constrained by the cap (i.e., held MBLs over 5% of assets). Today, nearly 30% are constrained. In addition, ten years ago only one-half of MBLs resided in constrained credit unions. Today, fully three-quarters of MBLs are on the books of constrained credit unions. **Without an increase in the cap, credit union business lending will have to slow.**

MBL Credit Unions: Distribution Changes
Data as of June. Excluding Non-Grandfathered CUs.
Sources: NCUA and CUNA.

MBLs/Assets	Percent of Total Non-Grandfathered MBL Credit Unions				Percent of Total Non-Grandfathered MBLs		
	2001	2006	2011		2001	2006	2011
>0% to 5.0%	90.3%	79.6%	71.6%		51.0%	32.2%	25.3%
5.0% to 7.5%	4.3%	8.7%	12.5%		22.8%	20.3%	24.0%
7.5% to 10.0%	3.0%	6.0%	7.8%		15.6%	19.5%	24.6%
>10.0% to 15%	2.4%	5.7%	8.1%		10.5%	28.0%	26.1%

The banks also claim that the credit unions constrained by the cap are a “new breed” of large credit unions. Again, this is false: roughly 75% of the almost 600 credit unions that are constrained by or at the cap have total assets of $500 million or less.

The impact of the cap on business lending credit unions is clear, but the effect of the cap on credit unions that may have demand for, but do not offer, business loans is also significant. The cap effectively limits entry into the business lending arena on the part of small- and medium-sized credit unions—the vast majority of all credit unions—because the startup costs and requirements, including the need to hire and retain staff with business lending experience, exceed the ability of many credit unions with small portfolios to cover these costs.

Today, the economics of the restrictive 12.25% cap make it very difficult for credit unions with less than $45 million in assets to be involved in business lending. Indeed, over two-thirds 68% of the nation's 7,400 credit unions have $45 million or less in total assets but only 530 credit unions this size (25% of MBL credit unions) offer member business loans.

The 12.25% cap implies that a $45 million credit union is currently limited to $5.6 million in member business loans (roughly 25 loans in total using industry loan-size averages). Using conservative estimates, a portfolio this size would generate an annual net loss of about $10,000, with approximately $170,000 in income but with expenses totaling $180,000 (approximately $88,000 for the salary and benefits of an experienced lender, $28,000 in loan losses and roughly $56,000 in other operating expenses.).[15] Smaller institutions would incur larger net losses on their portfolios because many of the costs incurred are fixed.

Raising the cap to 27.5% of assets would change the economics significantly – making it possible for credit unions as small as $20 million to reasonably participate in this market. This would open the market to over 700 additional credit union lenders.

[15] Net interest and fee income equal to 3% of invested funds; annual losses equal to 0.50% of outstanding balances; $88,000 salary and benefit expense for an experienced commercial lender; other operating expenses equal to 1% of outstanding balances.

The banks also note that the government-guaranteed portion of a credit union member business loan does not count against the MBL cap.

While this is true, it is important to keep in mind that government loan guarantee programs are not appropriate or necessary for every borrower. And, the decision to pursue a government-guaranteed loan is the decision the borrower makes, not the credit union. There are many regulatory hoops for the borrower and the lender to jump through, rates are not always competitive and they can take longer to approve. At Coasthills, like many other credit unions, we offer all options to our member business owners and many have opted not to go the SBA route.

The banks say that expanded credit union business lending is inconsistent with the credit union mission.

Credit unions exist to serve the credit needs, including their business credit needs, of their members. The fact is that credit unions have been providing business loans to credit union members since their creation. The earliest credit unions were founded so that people could borrow money to buy goods at lower cost and sell them for a profit. The founders of the American credit union movement very specifically noted the important role credit unions should play in providing access to credit for small businesses. As Alphonse Desjardin said, in 1908, when he encouraged the founders of St. Mary's Bank Credit Union in New Hampshire to organize what would become the first credit union in the United States:

> "There are not only the manual laborers, whether of industry or of the land, who need credit and who, very often, are forced to suffer the extortions of the Shylocks of usury: There is also a very interesting class of small merchants, of humble industrialists, of modest entrepreneurs whose financial status does not permit them to have access to the large banks where their well enough known fellow businessmen go to stock up in order to enjoy the

> benefit of a checking account. To all of them as well, the cooperative offers financial assistance that is most precious."[16]

Roy Bergengren, who led the expansion of credit unions in the early 1930s which led to the enactment of the Federal Credit Union Act, wrote about the duties and responsibilities of a credit union. In his 1935 book, he writes,

> "[A credit union] is a bank of credit for its members enabling them to borrow in time of credit necessity at normal interest rates for provident purposes. This includes… loans may be constructive – that is, loans designed to help the member improve his lot economically—to shingle his house, pay his taxes, build a garage, pay for education, buy into a small business and do anything, the doing of which will, in the opinion of the credit committee, assist the member to be better off than he was before the loan was made."[17]

Serving the business borrowing needs of credit union members is not only a part of the credit union mission, it is part of the credit union DNA. For the first 90 years of credit unions' existence in the United States, there was no statutory business lending cap for credit unions, and some credit unions developed as primarily business lending institutions.

The banks say that business lending is riskier and raises serious safety and soundness concerns. They also say that credit unions lack experience in commercial lending.

The banks would have Congress believe that the imposition of the credit union member business lending cap in 1998 was because there was a business lending crisis in the credit union movement or some overwhelming concern over the safety and soundness of credit union business loans. The fact of the matter is Congress imposed a statutory cap on credit union member business lending in 1998 at the behest of the banking industry which opposed the *Credit Union Membership Access Act of 1998*. The Clinton Administration, in its Statement of

[16] *L'Avenir National* (Manchester, N.H.), Vol. XXI, No. 67, 28 November 1908, p. 4-5.
[17] Bergengren, Roy. "CUNA Emerges: A Third Credit Union Book" Kingsport Press, Inc. 1935. 54.

Administration Policy to H.R. 1151 stated there was no economic or safety and soundness rationale for restricting credit union business lending by statute.

> "The Administration sees no safety and soundness basis for an amendment that would limit the ability of credit unions to make business loans to their members. Existing safeguards, coupled with the new capital and other reforms in the bill, are sufficient to protect against any safety and soundness risk from member business loans."[18]

Make no mistake: the inclusion of the statutory cap on credit union member business lending in legislation that credit unions needed enacted in order to preserve the ability of millions of Americans to continue their credit union membership had nothing to do with the riskiness of credit union business loans. And it still does not today.

In fact, credit unions have a long history of engaging in safe and sound business lending. Business lending at credit unions is much safer than at other institutions, contrary to ICBA's suggestion.

According to NCUA and FDIC data, credit union member business loan net charge-off rates have been significantly lower than bank rates year-in and year-out for over a decade. In the period between 1998 and 2007, credit union member business loan net charge-off rates have averaged 0.08% per year, a figure that is less than **one-eighth** the 0.70% bank average over the same period.[19] More recently, the financial crisis and recession have increased losses at all lenders. However, the increase in loss rates at credit unions pales in comparison to bank results. Since the financial crisis began, credit unions charged off commercial business loans at a 0.63% rate – less than half of the 1.57% rate reported by banks over the same period.[20]

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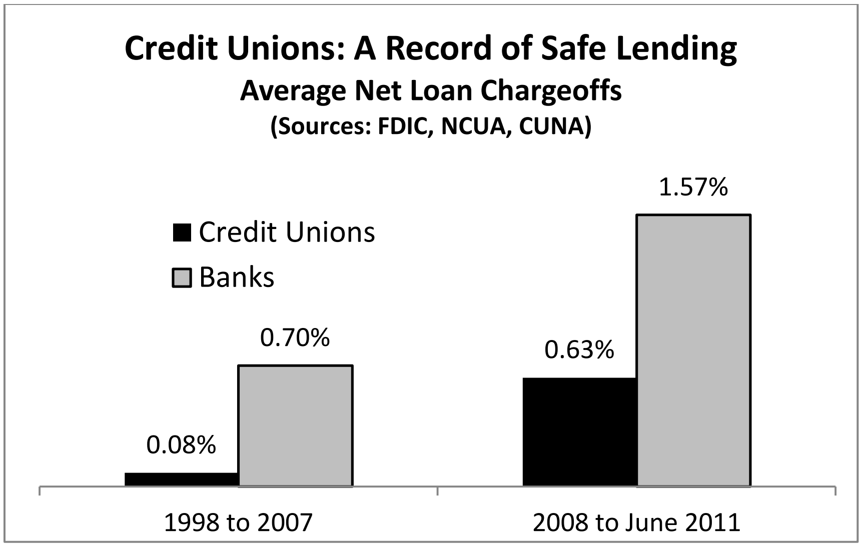
[18] Statement of Administration Policy. H.R. 1151 (105th Congress). July 22, 1998.
[19] NCUA Call Reports and FDIC Statistics on Depository Institutions.
[20] Ibid.



Compared to other loans at credit unions, business loan net charge-off rates are lower than net charge-off rates on credit union consumer loans and nearly identical to the net charge-off rates in credit union real estate loan portfolios.[21]

Relatively low charge-offs are NOT confined to credit union business lending portfolios. Credit union net charge-offs are substantially lower than bank net charge-offs in each loan category. This lower loss experience at credit unions is the result of their operation under a cooperative structure, which provides much lower incentives to take on risk than a for-profit structure.[22]

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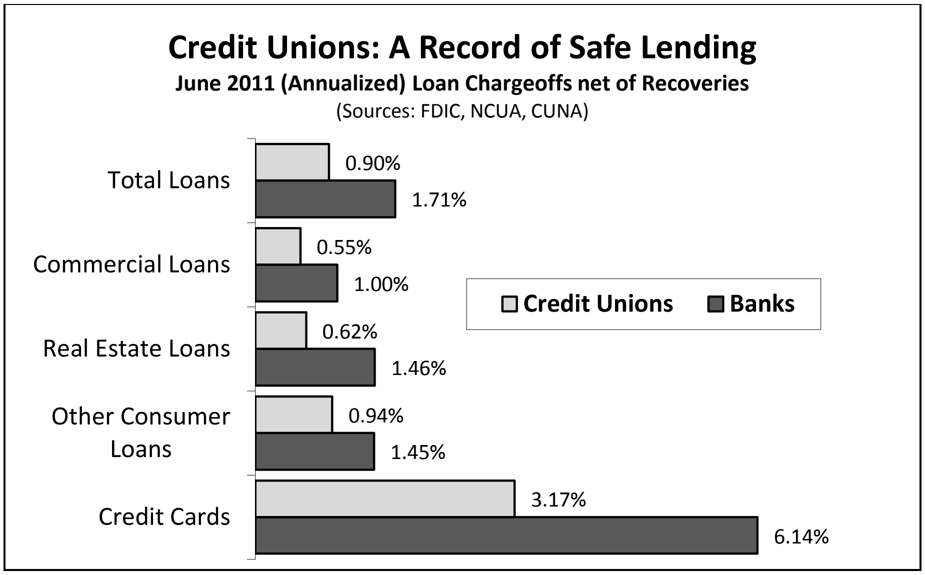
[21] NCUA Call Reports.

[22] Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Journal of Banking and Finance, 20(September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.



Furthermore, most credit unions have excess liquidity today which is depressing their overall earnings. Moving assets from low-yielding investments into higher-yielding member business loans, even after accounting for possible credit losses on those loans, will increase credit union earnings, capital contributions, and overall safety and soundness.

NCUA has full authority to supervise credit union business lending, and has been proactive in overseeing credit unions in this area. That regulation is no doubt an important reason behind the very low loss rates experienced on credit union business loans over the past decade. NCUA Chairman Matz emphasized in a February 24, 2010, letter to Treasury Secretary Geithner:

> "If legislative changes increase or eliminate the aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns."[23]

It is also important to keep in mind that, under H.R. 1418, only credit unions with significant business lending experience would be able to apply to lend in excess of the current

[23] http://www.ncua.gov/news/press_releases/2010/MA10-0225MatzLending.pdf

statutory cap, and then only after approval by NCUA on a credit-union-by-credit-union basis. The safeguards in the legislation combined with the oversight of the regulator, and credit unions' record of prudent lending should satisfy concerns that the increased lending permitted by this legislation would jeopardize the safety and soundness of credit unions.

The banks say that credit unions that want to do additional business lending should convert to a mutual thrift charter.

Credit unions are member-owned, not-for-profit financial cooperatives. They provide access to financial services to their members who benefit in the form of lower rates on loans, higher returns on deposits, lower fees and better customer services. Credit union members benefit to the tune of $6.5 billion per year because of the existence of credit unions. When a credit union converts to another charter, the members lose these benefits. We believe not only would it be bad public policy but also it would run counter to the mission of credit unions to require credit union members to forfeit the democratic control of and the benefits of belonging to their institution just so it can provide the credit union's small business-owning members additional access to business lending credit.

The banks suggest that credit unions are not fulfilling their tax exempt mission.

The credit union tax status arises from their unique structure as not-for-profit, democratically-controlled financial cooperatives. That structure is unchanged over the past 100 years. As clearly spelled-out by Congress in the findings that are part of the Credit Union Membership Access Act of 1998, credit union products and services are not related to the tax exemption.

Credit unions take their mission to serve the needs of their members very seriously and part of the credit union mission is to serve those of modest means. Many modest means individuals run small businesses and need credit. This is especially the case in during today's economic downturn because unemployed and discouraged job seekers are more likely to form businesses during such periods.

Treasury's comprehensive analysis of credit union business lending showed that credit unions do a very good job of serving the business credit needs of low and moderate income business owners. Treasury found that 25 percent of member business loans were made to members with household income of less than $30,000 -- and that these loans totaled 13 percent of the outstanding member business lending balances. Another 20 percent of the loans (with 15 percent of the outstanding loan balance) went to households with incomes reported to be between $30,000 and $50,000.[24]

Beyond business lending, credit unions do an outstanding job of serving those of modest means. For instance, Home Mortgage Disclosure Act (HMDA) data – the primary data source in CRA examinations – clearly and consistently show that compared to banks, credit unions make a greater percentage of their loans to lower income individuals. HMDA data also reveal that lower income households are substantially more likely to be approved for loans at credit unions and substantially less likely to be denied a loan at credit unions.

For example, an analysis of HMDA data shows that, since 2005, credit unions have approved an average of 68% of applications from low/mod income borrowers, whereas other lenders approved an average of only 51% of these applications. Moreover, since 2005, an

[24] United States Department of the Treasury, *Credit Union Member Business Lending*, January 2001. 3.

average of 26% of total credit union mortgage originations were to low/mod income borrowers while low/mod income originations represented 23% of total originations at other lenders.

It is worth noting that credit unions have repeatedly attempted to reach out to serve more individuals in lower-income households. However, banks have used the courts to bar those efforts. One such instance occurred in 2005 when the ABA took NCUA to court to limit credit unions' ability to serve underserved areas days after the ABA had testified before Congress that credit unions were not doing enough to serve the underserved.[25] The bank tactic of claiming that credit unions are not "doing enough" on the one hand while simultaneously erecting obstacles to the provision of credit union service does nothing to help these communities.

The banks say that increased credit union business lending would come at an increased cost to taxpayers because it would displace lending by banks.

There are several flaws associated with this claim and the way this has been scored by the Congressional Budget Office. Chief among these are:

1. An increase in credit union business lending will not likely lead to an equal reduction in bank business lending for reasons explained below.
2. Even if credit union business lending does crowd out some bank business lending, that would not result in a reduction in bank assets; rather the bank assets would more likely be redeployed from business loans to securities or perhaps other types of loans.
3. Also, the increased credit union business lending would simultaneously increase tax revenues paid by the small businesses that borrowed from credit unions because credit unions typically charge lower rates on loans than banks do.

[25] American Bankers Association v. National Credit Union Administration (2005).

Economic theory helps to shed some light on the extent to which credit union lending may or may not "crowd out" bank business lending. Raising the credit union business lending cap is equivalent to an increase in the supply of business credit. Unless the demand for business loans is totally price inelastic, that increase in supply will lead to some increase in loans (i.e. the demand curve is not vertical). Recently, researchers at the Federal Reserve Board estimated a semi-elasticity of demand for unsecured business loans to be -1.4, implying that a 100 basis point reduction in loan rate would be associated with a 1.4% increase in the amount of loans demanded.[26] This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using the Federal Reserve's estimate, and considering that only about 5% of the small business loans held by all depository institutions are held by credit unions and that the proposed legislation would limit annual loan growth above the current cap to 30%, the vast majority of credit unions' new lending could be accomplished without any reduction in bank loans. Suppose that credit union lending doubled as a result of increasing the cap, and all of the loans came from banks. That would still leave banks with 90% of the small business loan market. How much more than that do they need?

Across the board on virtually all standardized consumer financial products, credit unions typically charge lower rates and fees, and pay higher dividend rates, than do banks.[27] However, because of the variety of types of business loans, and differing terms and conditions available within types, there is no standardized comparative data on bank and credit union business loan pricing. A small business loan is just not a commodity in the sense that a credit card or five-year

[26] Basset, William F., Chosak, Mary Beth, Driscoll, John C., and Egon Zakrajsek (All of the Division of Monetary Affairs, Federal Reserve Board.) "Identifying the Macroeconomic Effects of Bank Lending Supply Shocks." December 2010. 18. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832.
[27] See, for example, Informa (a CUNA-endorsed vendor), Datatrac (an ABA-endorsed vendor) and/or Ratewatch interest rate databases.

new car loan is. Nevertheless, we believe there is abundant available evidence regarding the better terms credit unions provide for consumer financial products. This evidence shows that a business that receives a loan from a credit union is very likely to pay less on average than it would for the equivalent loan from a bank. This would boost small business profits and tax payments.

Conclusion

Madame Chairman, small businesses need help accessing credit. Credit unions were formed to provide their members access to credit. Despite what banks may have you believe, credit unions have been lending to their members for business purposes since their founding over 100 years ago, and credit unions continued to lend throughout the financial crisis, expanding their business lending portfolios while the banks contracted their lending.

Congress has identified that small businesses are having trouble accessing credit. One response was to give the banks access to $30 billion of taxpayer money. Regrettably, only a small fraction of that money was claimed by the banks, and some of that money was used to repay their taxpayer bailout obligations. While the program had the right idea – trying to get capital to small businesses –the banks did not come to the plate. The actions of the banks over the last several years should make it clear to all that small businesses would be well served with greater access to credit union capital. The history of credit union business lending suggests that credit unions are up to the task.

The consequences of Congress failing to enact this legislation would be a travesty for small businesses and communities throughout the country. At a time when millions of American's are out of work, small businesses this legislation passed. Without this legislation, credit union business lending growth – the only sector where business lending has expanded over the last three years – will slow, not the mention the fact that the 140,000 jobs that could be created will go uncreated.

Credit unions are ready and willing to continue to lend to small businesses. Credit unions have the capital to lend and a history of lending safely and soundly. The legislation will allow the most experienced credit unions to meet the demand for small business loans in a manner that is safe and sound.

H.R. 1418 gives Congress the opportunity to help small businesses hire 140,000 workers at no cost to taxpayers. This is a commonsense bipartisan bill. We encourage Congress to enact H.R. 1418.

Thank you very much for the opportunity to present our views on this legislation.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Jeff York	Credit Union National Association
3. Business Address and telephone number: [redacted]	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? ☐ Yes ☑ No	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify? ☐ Yes ☑ No
6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature:	

Please attach a copy of this form to your written testimony.