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STATEMENT

OF

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“H.R. 1418: THE SMALL BUSINESS LENDING ENHANCEMENT ACT OF 2011”

BEFORE THE

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

WEDNESDAY, OCTOBER 12, 2011

I. Introduction

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, the National Credit Union Administration (NCUA) appreciates the invitation to testify before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit to provide views on credit unions, member business lending, and legislation proposed by Congressman Edward Royce and Congresswoman Carolyn McCarthy known as the Small Business Lending Enhancement Act of 2011 (H.R. 1418). This hearing is an opportunity to consider legislation that would help small businesses grow, create new jobs, provide needed community services, and bolster the U.S. economy.

Specifically, the Subcommittee has asked NCUA to comment on H.R. 1418, including the effect of this legislation on economic growth and competitiveness. The Subcommittee has also asked whether H.R. 1418 contains appropriate safety and soundness protections. In general, H.R. 1418 would increase access to credit for small businesses in a way that prudently protects safety and soundness. As a result, NCUA supports H.R. 1418.

This written testimony will provide a general background and history of credit union member business lending, including the reasons why statutory member business loan limits often inhibit credit unions from meeting the financing needs of creditworthy members who are self-employed or small business owners. It will highlight current member business lending trends as the U.S. economy, including credit unions, continues to rebound from the largest financial crisis since the Great Depression. Most importantly, it will demonstrate how prudently raising the MBL cap would benefit small businesses, local communities, and the U.S. economy.

II. About NCUA

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public function by examining all federal credit unions, participating in the supervision of federally insured state-chartered credit unions in coordination with state regulators, and insuring federally insured credit union members' accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund (NCUSIF),[1] NCUA provides oversight and supervision to 7,239 federally insured credit unions, representing 98 percent of all credit unions and 91 million members.[2]

III. Importance of Small Businesses Having Access to Credit

The U.S. economy runs on credit. Businesses, especially small businesses, count on credit to finance their inventories, meet weekly payrolls, and generally keep their operations going. When the supply of credit contracts suddenly, these normal operations can be disrupted; inventories can be liquidated at fire-sale prices, businesses may lay off workers, and other expenses — including purchases from other businesses — may be cut.

[1] The NCUSIF was created in 1970 by Public Law 91-468 (Title II of the Federal Credit Union Act), which was amended in 1984 by Public Law 98-369. The NCUSIF was established as a revolving fund in the United States Treasury under the administration of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state credit unions that request insurance. As of June 30, 2011, the NCUSIF had total assets of $11.2 billion dollars.
[2] Approximately 150 state-chartered credit unions are privately insured and are not subject to NCUA oversight. The term "credit union" is used throughout this statement to refer to federally insured credit unions.

Aggregate credit supply disruptions help to generate particularly painful recessions and have, in the past, also been associated with weak recoveries. The “Great Recession” — which started in December 2007 and technically ended in the middle of 2009 — is a good example. Credit availability dropped sharply in the early stages of the recession. In the last six months of 2008, more than 70 percent of banks were tightening standards on commercial and industrial loans to borrowers of all sizes, and more than 80 percent were tightening standards on commercial real estate loans. Loan volume, especially for small businesses, contracted sharply. From the third quarter of 2008 through the end of 2009, bank loans (excluding mortgages) to non-farm, non-corporate businesses fell almost 20 percent.

The economic consequences of the recent credit contraction were immediate and severe. Businesses slashed inventories, consumer demand disappeared, and layoffs surged. From December 2007 to the employment low point in February 2010, the economy lost 8.7 million jobs.

The economy then improved somewhat from early 2010, although it remained well below its potential and lending was sluggish. More recently, due to a variety of shocks, including a jump in oil and gasoline prices, a sharp retreat in consumer confidence, and rising risks from a potential sovereign default in the Eurozone, the recovery has weakened. U.S. payrolls in September 2011 were still 6.6 million jobs below December 2007, and the pace of job growth slowed to less than 75,000 per month over the five months ending in September. Real GDP grew less than 1 percent at an annual rate in the first half of the year. Consumer and business confidence dropped in the middle of the year. Financial volatility has jumped and major stock price measures have tumbled in the face of growing risks. Throughout the recovery, small business lending has remained stagnant.

Impact on Small Businesses

The recession hit small businesses harder than larger firms, and small businesses have been slow to rebound. Recent research indicates that employment at firms with fewer than 50 employees — accounting for about 40 percent of private sector employment — fell more than 8 percent from December 2007 through June 2009, while employment at all other businesses fell by 4.5 percent. During the recovery's early stages between July 2009 and November 2010, employment at firms with fewer than 50 employees declined roughly another 3 percent, while employment at larger firms rose.

More recent statistics suggest small businesses continue to struggle. According to the National Federation of Independent Business, small business optimism has fallen since the beginning of the year, reaching an 18-month low in August 2011.

While conditions in financial markets have improved, access to credit remains difficult for many small businesses and entrepreneurs that depend on financial institutions for such funding. According to Federal Deposit Insurance Corporation (FDIC) Statistics on Depository Institutions, net loans and leases by all FDIC-insured institutions fell by 8.9 percent between year-end 2007 and the second quarter of 2011, including a decline of

0.5 percent so far in 2011. Information on “small business” loans — defined as loans less than $1 million — shows that between the mid-year 2007 and the second quarter of 2011, total small business loans secured by non-farm, non-residential properties fell by 10 percent. Small business commercial and industrial loans dropped by 13.4 percent over the same period.

Credit unions, however, continued to serve as a source of credit for consumers and small businesses during the economic downturn and recovery. While credit contracted during and after the financial crisis, credit unions continued to lend. Over the period from year-end 2007 through the second quarter of 2011, credit union lending increased by about 6 percent. Total credit union member business loans (MBLs), in particular, increased by nearly 44 percent during this timeframe. MBLs with portions guaranteed by the Small Business Administration (SBA) grew by 70 percent.

Credit Unions’ Small, but Important Role in Business Lending

While shoring up private demand would help the economy, improving access to credit can also play a role in expanding the economy. Although credit unions make up only approximately 1 percent of total business lending in the United States,[3] credit unions serve an important role in lending to small businesses. Credit unions also continued to extend credit during the economic downturn. Today, credit unions have more than

[3] NCUA compares total credit union commercial mortgage debt outstanding to the Mortgage Bankers Association Quarterly Survey or Commercial Mortgage Debt Outstanding as a proxy for market share. Credit unions provide 1.3 percent of commercial mortgage debt based on total commercial mortgage debt as published in the June 30, 2011 Mortgage Bankers Association quarterly report of Commercial/Multifamily Mortgage Debt Outstanding. The full report can be viewed at http://www.mortgagebankers.org/files/Research/CommercialServicing/Q211CMFDebtOutstanding.pdf.

170,000 outstanding MBLs to businesses, and a dollar-weighted average MBL balance of $222,000 — indicating credit unions are predominantly serving the needs of smaller businesses.[4]

Small businesses rely on external financing from financial institutions far more than larger businesses which often have access to the capital markets. Smaller financial institutions, including credit unions, play a critical role in providing credit to small businesses, which in turn will help create jobs and spur economic growth.[5]

Credit unions serve an important niche, typically making the smallest of the small business loans. As stated earlier, the dollar-weighted average credit union MBL is $222,000. The two most common types of loans — non-farm residential property loans and commercial and industrial loans — average $165,000 and $128,000, respectively.[6]

Recent research conducted for the SBA suggests that credit unions have played an increasingly important role in ensuring small firms have access to needed credit.[7] According to the report, MBLs at credit unions accounted for about 6 percent of all small business loans in 2010, and credit unions expanded their lending through the recession, even as bank lending to small businesses contracted. Using data constructed for the study, in 2010, for example, loans from credit unions to member small businesses rose

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[4] The median of the average member business loan size by credit union lender is only $126,316.

[5] Commercial banks with less than or equal to $10 billion in assets account for only 18 percent of assets, but 44 percent of small business commercial and industrial lending (using the FDIC definition). All but three credit unions have less than $10 billion in assets.

[6] By comparison, over the past year the average bank commercial and industrial loan amount was about $675,000 according to the Federal Reserve's *Survey of Terms of Business Lending*.

[7] See http://www.sba.gov/sites/default/files/files/rs387tot.pdf.

5 percent, while small business loans from banks fell 7.6 percent (after adjusting for inflation).

Importantly, results from the SBA study suggest that credit union lending to member small businesses adds to the overall availability of small business loans. Empirical results suggest that each dollar of new member business lending by credit unions generated 81 cents of an entirely new credit source for small businesses. So, lending to small business is higher when credit unions are making small business loans. In other words, most credit union member business lending is not simply taking the place of small business lending that banks would have done anyway. As a whole, the report's findings suggest that credit union lending to small business could play an increasingly important role in ensuring the sector has adequate access to credit.

IV. Credit Union Member Business Lending History

Credit unions have a long history of meeting the business lending needs of their members, dating back to the U.S. credit union industry's inception in 1908. From their roots, credit unions have played a small, yet crucial role in supplying credit to farmers, immigrants, and small business owners. The first credit union chartered in the United States, St. Mary's Bank Credit Union, had as its primary lending focus to "establish neighborhood business." Over the last century, credit union business lending has evolved from providing mostly agricultural and farming loans to funding small business start-ups as well as contemporary commercial real estate projects undertaken by credit union members.

Credit Unions Have a Successful Business Lending History

For decades, many credit unions have successfully provided credit to meet the business needs of their members. Congress recognized this fact in 1998 when enacting the Credit Union Membership Access Act (CUMAA).[8] CUMAA provided an exception to the business lending cap for those credit unions with a "history of primarily making business loans."

Centris Federal Credit Union, chartered in 1934, is one of the institutions that met the criteria for this statutory exception. The SBA recently recognized Centris Federal Credit Union "as a community lender having a significant impact on underserved markets in its area, as the number of loans approved for this segment increased by 83% from 2009 to 2010 and the gross dollar amount approved increased by 230.29%." The SBA also stated that "while portfolio performance played a significant role in the awards, the institutions' continued support of small business, especially in underserved communities during challenging economic times was also a major factor."[9]

NCUA Regulated MBL Activity Prior to Statutory MBL Limits

During the late 1980s, credit unions increasingly established and engaged in member business lending, but some lacked the necessary expertise in underwriting and servicing such loans. Given that lack of necessary expertise combined with the challenging macroeconomic conditions at the time, over a two-year period in the late

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[8] Public Law 105-219.

[9] *Six Lenders and Two Investment Companies Receive Top SBA Recognition at National Small Business Week*, SBA Press Release, May 20, 2011.

1980s, nearly half of the losses sustained by the NCUSIF directly or indirectly resulted from losses in business lending portfolios.

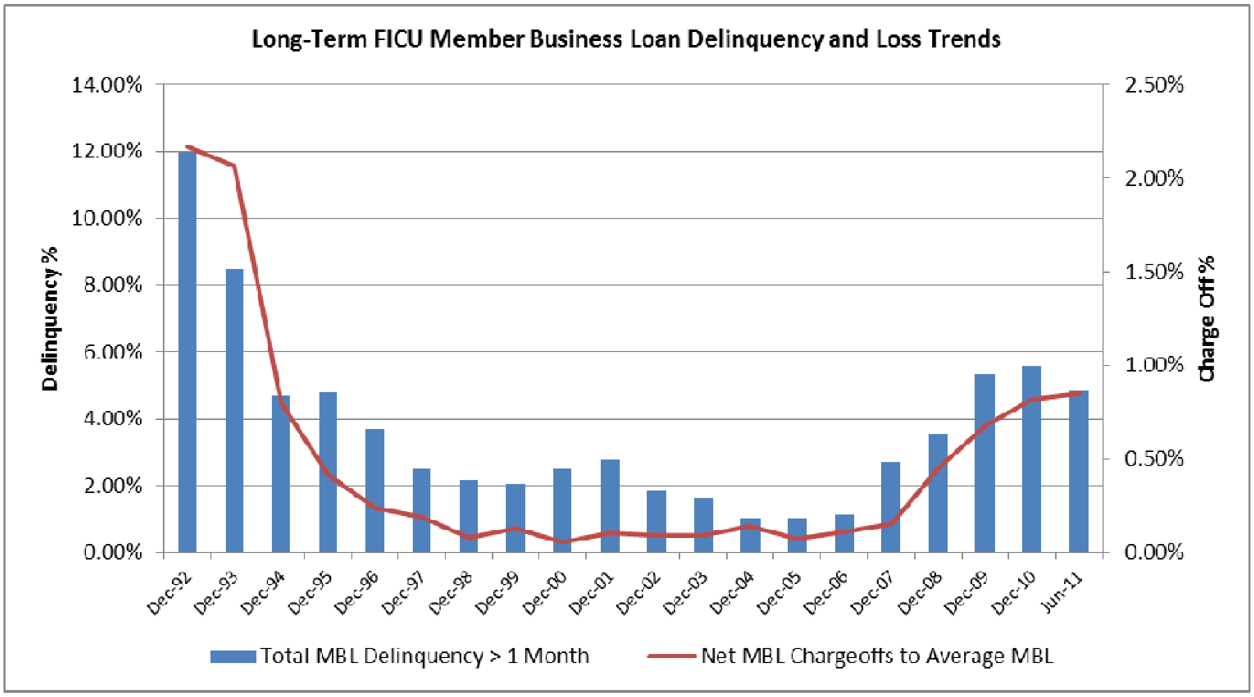
Since then, NCUA has increased supervisory oversight of credit unions involved in business lending, especially those in challenging markets. NCUA also began collecting more specific member business lending data on credit union Call Reports.

In 1987, the agency adopted its first Rule and Regulation specifically devoted to member business lending. This regulation — now encompassed by Part 723 of NCUA's Rules and Regulations — provided a more robust prudential regulatory framework to better manage the risks business lending activity poses to credit unions and the NCUSIF.[10]

NCUA has periodically made various enhancements to the member business lending rule. Over the years, NCUA has increased underwriting standards, collateral requirements, and management qualifications. On the whole, NCUA's regulatory and supervisory efforts have proven successful in mitigating losses from member business lending. As Figure 1 shows, these rules also set a solid foundation for this form of credit to be extended in a safe-and-sound manner during the 1990s, without any aggregate cap on member business lending prior to 1998.

[10] NCUA's member business lending rule is applicable to all federal credit unions (FCUs) and the vast majority of federally insured state-chartered credit unions (FISCUs), except for those FISCUs in six states that maintain their own MBL rule with NCUA's approval. These six states are Connecticut, Maryland, Oregon, Texas, Washington, and Wisconsin.

Figure 1



Member Business Lending Statutory Cap

In 1998, CUMAA codified in the Federal Credit Union Act the definition of an MBL[11] and established a statutory aggregate limit on outstanding MBLs that most credit unions could hold. CUMAA set the aggregate limit on a credit union's net member business loan balances as the lesser of 1.75 times the credit union's net worth or 12.25 percent of the credit union's total assets. Under CUMAA, certain loans, such as loans less than $50,000 or portions of loans guaranteed by a governmental agency like SBA, are not counted for the purpose of the aggregate loan limit.

[11] Under the Federal Credit Union Act's definition incorporated in NCUA's Rules and Regulations, an MBL is defined as any loan, line of credit, or letter of credit, where the proceeds will be used for a commercial, corporate, other business investment property or venture or agricultural purpose. See 12 CFR 723.1(b) and (c).

The statute exempts from the aggregate member business lending cap credit unions meeting any of the following criteria:

(1) credit unions with a low-income designation or participating in the Community Development Financial Institutions Program;[12]

(2) credit unions chartered for the purpose of MBLs; and

(3) credit unions that had a history of primarily making MBLs when the statute was enacted.[13]

Collectively, 1,179 credit unions presently qualify for these exemptions. Thus, the other 6,060 credit unions — about 84 percent of all credit unions, representing 94 percent of assets — are subject to the statutory cap. Of these 6,060 credit unions, 1,829 currently make MBLs, which collectively represents 75 percent of all current member business lending.

The statutory cap acts as a deterrent, keeping many credit unions out of member business lending entirely. With the cap, it is difficult to achieve the necessary economies of scale in terms of personnel and systems to make this type of lending activity cost-effective, especially for smaller credit unions. As a result, some credit

[12] There are 1,118 credit unions that are low-income designated and/or participate in the CDFI Program. The median asset size for these credit unions is $8.5 million. Twenty-five percent of these credit unions grant MBLs.

[13] There are 120 credit unions, with $24 billion in assets, which were either chartered for the purpose of making MBLs, or have a history of primarily making MBLs. This small subset of credit unions accounts for more than one-third of all credit union agricultural lending. Fifty-nine of these 120 credit unions are also low-income designated and counted in the footnote above.

unions that would otherwise elect to meet their members' business financing needs do not offer MBLs.

Figure 2 shows the number of credit unions subject to the cap participating in member business lending and the extent of their participation relative to the asset-based cap. For example, approximately 30 percent of credit unions subject to the cap offer MBLs. Nearly 75 percent of credit unions subject to the cap with more than $100 million in assets offer MBLs. As of June 2011, 403 non-exempt credit unions are at or above 50 percent of the current statutory MBL cap, and hold approximately half of the outstanding balance of credit union MBLs.

Figure 2

Member Business Lending Compared to Current Statutory Limit: Second Quarter 2011

Credit Unions Subject to the Statutory Cap

				MBL Share of Assets Relative to 12.25% Cap			
Asset Class	Credit Unions	Total Assets ($B)	Total MBL ($B)	No MBL	Less than 50%	50% to 80%	80%+
				--------------------(Number of CUs)--------------------			
<$10M	2,065	8.41	0.01	2,007	53	3	2
$10M to $50M	2,058	50.20	0.39	1,569	427	36	26
$50M to $100M	685	48.45	0.69	368	263	34	20
$100M to $500M	890	196.73	5.66	254	476	102	58
$500M to $1B	196	137.94	6.42	20	111	37	28
$1B+	166	439.60	15.31	13	96	37	20
Total	6,060	881.33	28.47	4,231	1,426	249	154

Notes: Excludes the 1,179 credit unions that are not subject to the statutory cap based on either low-income credit union status or a charter exclusion. There are 1,118 credit unions with low-income status and 120 credit unions with charter exemptions. Fifty-nine credit unions are exempted from the caps by both low-income status and charter exemptions.

As credit unions continue to offer MBL services to their members, more credit unions will approach the existing statutory MBL limit, thus limiting the avenues of credit available to small businesses. Credit unions will be legally compelled to decline loans to creditworthy members who own or are expanding their business, solely due to the statutory cap.

Legislation proposed by Congressman Royce and Congresswoman McCarthy, however, would allow well-capitalized and well-managed credit unions with a proven track record of member business lending to prudently grow their member business lending portfolios — in small, manageable increments — to as much 27.5 percent of total assets.[14]

This proposed statutory change would allow credit unions with well-managed member business lending programs to provide additional funding to meet the financial needs of their members and their communities, thereby contributing to an economic recovery and job growth. Further, the provisions of H.R. 1418 require NCUA to establish a tiered approval process to permit eligible credit unions to gradually increase the amount of member business lending in a manner consistent with safe-and-sound operations, and

[14] Under H.R. 1418, experienced credit unions operating in the second tier (above the current statutory cap) could not immediately increase their levels of MBLs. Subject to supervisory considerations, these credit unions could only increase their MBL portfolios on a gradual basis, by no more than 30 percent annually. Additionally, the legislation would prevent credit unions operating in the second tier that subsequently fall below a well capitalized level from underwriting new MBLs until such time as the credit union becomes well capitalized. Also, the legislation would establish safeguards to ensure that NCUA has the powers needed to protect the safety and soundness of credit unions engaging in increased levels of member business lending.

only after credit unions offering MBLs have demonstrated proper controls are in place to adequately manage the risks with these programs.[15]

The potential to reach a higher cap could lead more credit unions to make the economic decision to invest in the infrastructure, develop the policies, and hire the expertise needed to engage in an effective, prudent member business lending program. If H.R. 1418 becomes law, NCUA will ensure its existing member business lending regulatory framework is appropriately modified to facilitate safe-and-sound expansions in member business lending.

To better illustrate the effects of the existing MBL cap, consider the example of a well-capitalized, well-managed credit union with $100 million in assets. This credit union would today be capped at $12.25 million[16] in member business lending, which equates to just 55 average sized MBLs.

If this credit union is currently operating at 50 percent of the cap, at a 16 percent growth rate[17] it will cap out in less than five years. Because of the limited opportunity to grow the MBL portfolio, many credit unions have told me that they are reluctant to make

[15] For credit unions meeting certain criteria, H.R. 1418 would permit the NCUA Board to approve applications to operate in a second tier above the first tier for member business lending. Among others, these criteria would require the applying credit union to be well capitalized and well managed, have at least five years of experience in member business lending, and operate near the first-tier member business lending cap for at least four consecutive quarters. Credit unions receiving approval from the NCUA Board to operate in this second tier would have the ability to underwrite MBLs up to 27.5 percent of total assets.
[16] MBL cap is calculated as $100 million multiplied by the 12.25 percent statutory limit.
[17] The average annual growth rate between year-end 2005 and 2010 for credit union MBL programs has been 16 percent.

MBLs to additional members and further invest in the personnel and systems necessary to grow this line of lending.

With a 27.5 percent cap as contained in H.R. 1418, a well-capitalized, well-managed $100 million credit union would be able to make 124 average sized MBLs. A credit union at 50 percent of today's cap would have ten years at 16 percent per annum growth before it would cap out. This change in the statute would expand credit to a credit union's member small businesses and help a credit union to more effectively serve its members.

NCUA projects that credit unions could extend several billion more dollars in MBLs in the first few years after passage and implementation of H.R. 1418. If credit unions very near the cap — those credit unions at or above 80 percent of the cap — and most likely to qualify immediately for higher MBL limits under the bill increased member business lending by 30 percent, it is estimated that more than $2 billion in new credit could be extended. At the same time, if credit unions between 50 percent and 80 percent of the cap that are currently growing their member business lending portfolio responded to the new legislation by increasing their MBLs to 90 percent of the cap, another $1 billion in new lending could be generated. Together, credit unions operating at 50 percent or more of the current statutory MBL cap could increase member business lending by more than $3 billion.

In addition, some credit unions that are not presently near the cap, including some that do not make MBLs, are likely to increase their member business lending activity because they could achieve appropriate economies of scale over the long term with the higher cap. How quickly and to what degree these credit unions would respond is uncertain. Using conservative assumptions, it is possible that an additional $2 billion in credit could be made available through these channels over the next few years.

Combined with the estimated $3 billion in new capacity from qualified credit unions near the cap, a lifting of the cap could inject a total of more than $5 billion in needed credit for businesses into the economy. As noted earlier, a recent SBA study has found that 81 percent of new credit union MBLs would represent new small business loans that banks generally do not make. Put another way, four of five dollars credit unions would generate in small business loans would not have been granted by banks for that sector, based on recent history.

Additionally, although it may seem counter-intuitive, allowing credit unions to engage in more member business lending is another way in which to prudently manage risk. An increase in the member business lending cap would allow credit unions to diversify the risk of their loan portfolio, with MBLs typically involving less interest-rate risk than long-term, fixed-rate mortgages. This change is particularly important given the present low-interest rate environment.

V. Member Business Lending in Credit Unions Today

Within the constraints of the statutory cap on MBLs, many credit unions are striving to provide the credit needed by self-employed persons and small businesses. Such loans can have far-reaching and positive impacts throughout a community by creating jobs and promoting local commerce.

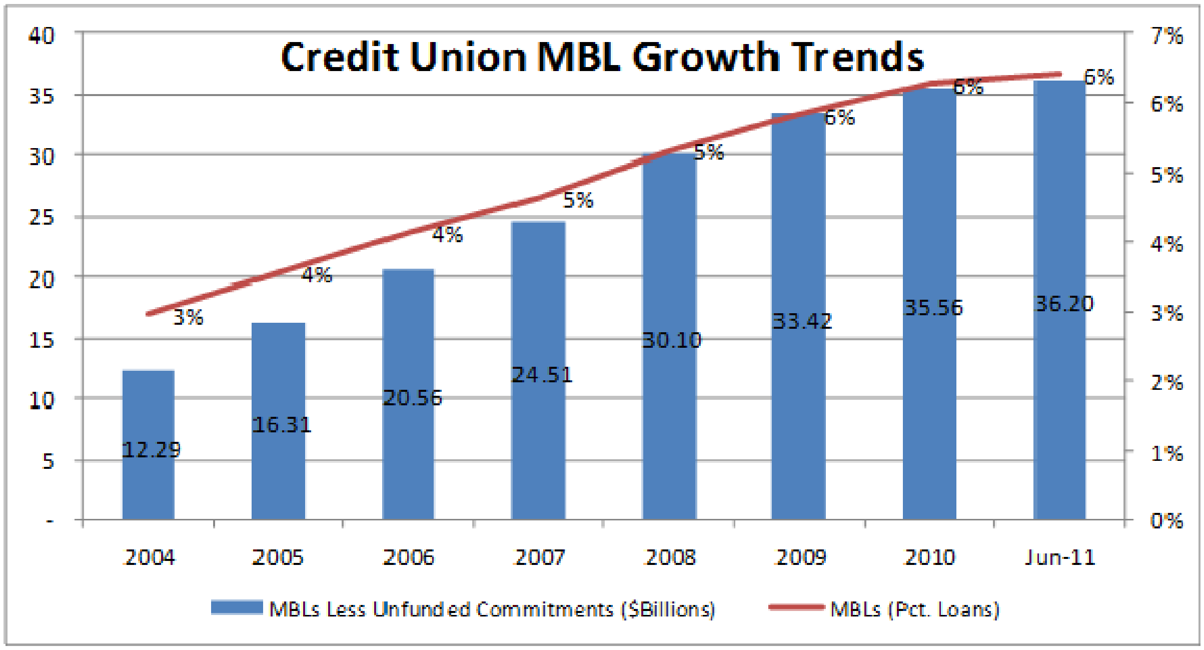
Credit Union MBL Statistics

As of June 30, 2011, 30 percent (2,178) of credit unions provide credit to businesses.[18] In general, the smaller the credit union, the less likely it is to engage in member business lending.

In 2010, credit unions originated or purchased $12.1 billion in MBLs. Another $6.3 billion in MBLs were added in the first half of 2011. Outstanding balances of MBLs as of June 30, 2011, total $36.2 billion (without unfunded commitments) and comprise 6.4 percent of total credit union industry loans and 4 percent of total credit union industry assets. Figure 3 provides a graphical representation of the current marketplace for credit union MBLs.

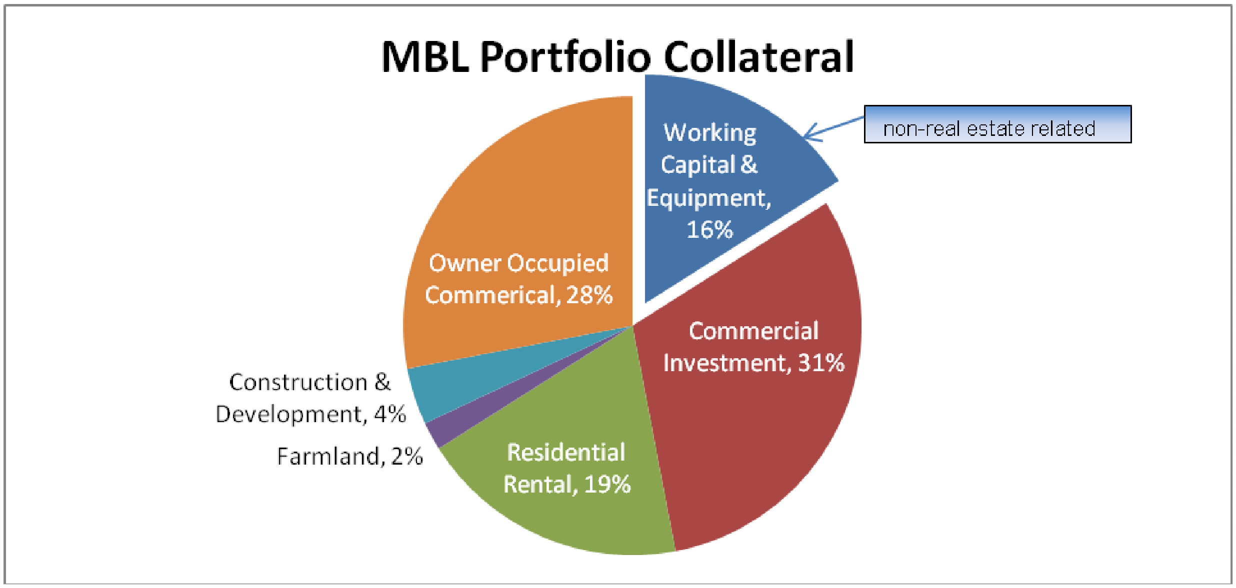
[18] Unless otherwise indicated, all data provided in this section is as of June 30, 2011.

Figure 3



The majority of MBLs, $29.8 billion or 82 percent, are secured by real estate. Agricultural-related MBLs have steadily grown to $1.4 billion, representing approximately 4 percent of total MBLs. A more complete picture of credit union member business lending is found in Figure 4.

Figure 4



More than one-third of all MBLs ($14 billion) are held by credit unions in three states. California credit unions account for the largest percentage of total MBLs (20 percent or $7.4 billion), followed by New York credit unions (11 percent or $4.2 billion), then Wisconsin credit unions (6 percent or $2.4 billion).

Credit unions in North Dakota, Minnesota, and Wisconsin continue to have the largest concentrations in agricultural MBLs, each with more than $100 million. For example, North Dakota credit unions report $527 million in agricultural MBLs, representing 78 percent of the state's total MBLs, with a portfolio delinquency rate of 0.55 percent — very low compared to business lenders nationwide.

Recent Stresses on MBL Performance

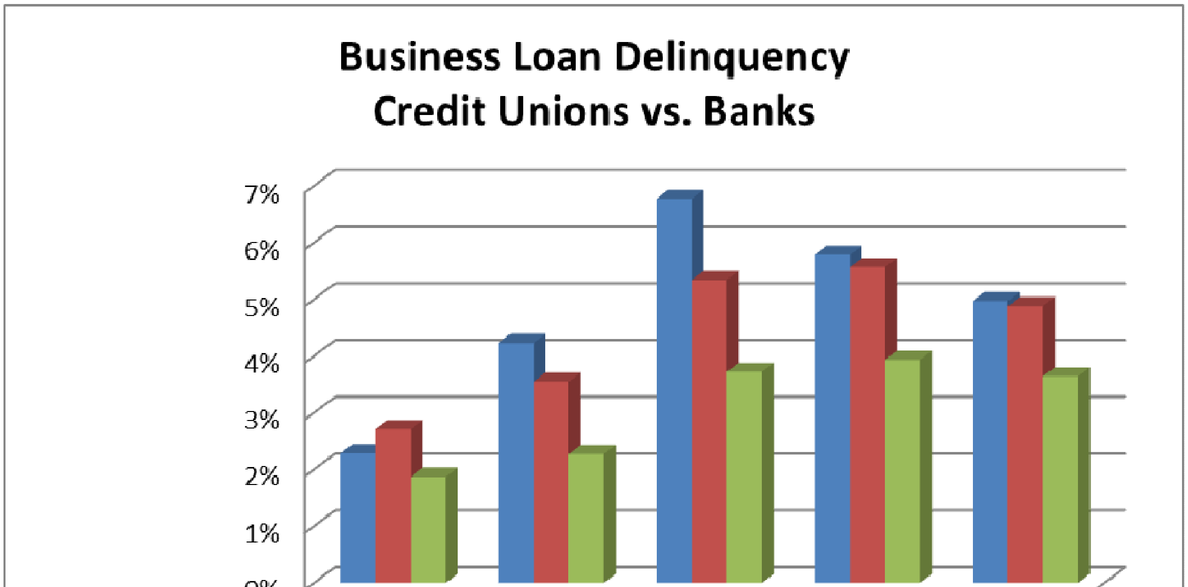
Like other types of loans, MBLs perform in a cyclical manner. Understandably, the member business lending portion of credit unions' loan portfolios has suffered from the adverse effects of the protracted economic downturn. The level of 60-day delinquent MBLs has increased from 0.53 percent at year-end 2006, to a high of 3.93 percent as of December 2010, moderating somewhat to 3.64 percent as of June 2011. The average MBL delinquency ratio by credit union, however, is 2.54 percent, indicating a few outliers are increasing the dollar-weighted delinquency level as they work through the impact of the economic downturn.

Credit unions located in states hit the hardest by the economic distress of the last few years hold a disproportionate amount of the delinquent MBLs. Most notably, the 328 credit unions located in the five "sand states" account for 39 percent of all delinquent MBLs, but only represent 15 percent of credit unions offering MBLs.[19] Losses on MBLs increased from 0.11 percent in 2006 to 0.85 percent (last 12 months as of June 2011). The credit unions located in the sand states account for 42 percent of losses on MBLs. Isolating the effect of MBLs made in the sand states — with California being most significant — the MBL delinquency ratio for the sand states is 5.1 percent, compared to a MBL delinquency ratio of just 3.1 percent for the rest of the nation.

[19] NCUA uses the term "sand states" to collectively refer to Arizona, California, Florida, Nevada, and Utah.

As Figure 5 illustrates, despite the recent increase during the economic downturn, current credit union MBL delinquency levels remain lower than other federally insured financial institutions.

Figure 5



	2007	2008	2009	2010	11-Jun
FDIC >30 days	2.28%	4.23%	6.77%	5.78%	4.97%
NCUA >30 days	2.71%	3.55%	5.34%	5.57%	4.88%
NCUA >60 days	1.87%	2.27%	3.72%	3.93%	3.64%

While MBL delinquencies and losses increased significantly during the economic downturn, they did not have a major impact on the safety and soundness of the vast majority of credit unions. Of the 55 credit union failures in 2009 and 2010, only one failure was primarily related to MBLs. MBLs were one of several factors contributing to the failure of eight other credit unions. Thus, the vast majority (84 percent) of credit union failures during this period were unrelated to member business lending. Losses to the NCUSIF for credit unions with MBLs as a contributing factor for 2009 and 2010 totaled $83.4 million, accounting for 20.5 percent of the $406 million in losses during that timeframe.

Reviews of the cause of each loss clearly point to individual credit union management deficiencies — not inherent flaws with member business lending in credit unions. Rather, managements' lack of planning, internal controls, and oversight of member business lending programs, and inadequate due diligence of third-party vendors played an integral part in the failure of these nine credit unions.[20]

An additional factor in several cases was the declining value of the underlying real estate serving as collateral on the MBLs. When real estate values declined to the point that credit lines were no longer supportable, the businesses defaulted.

While the nine failures illustrate some of the risks of member business lending if not well managed, member business lending can, with appropriate regulatory safeguards, be conducted in a safe, sound, and prudent manner. Such lending activity by credit unions can be of significant benefit to the small business community that is too often limited in its access to credit.

[20] Sometimes credit unions use credit union service organizations (CUSOs) or other third-party vendors to engage in various activities, including member business lending. NCUA is the only Federal Financial Institutions Examination Council (FFIEC) agency that does not have examination and enforcement authority over vendors. It is important to have examination and enforcement authority over vendors to properly identify and mitigate risks inherent to, or introduced by, vendor products for federally insured institutions. NCUA believes the agency should be provided with the same authority as other FFIEC agencies.

VI. Conclusion

NCUA recognizes the importance of small businesses and the jobs they create in our nation’s economy. H.R. 1418 has the potential to increase the access of small businesses to capital, promote job growth, and diversify credit union portfolios. As such, NCUA supports efforts to allow credit unions to provide member businesses additional avenues of credit when appropriate under a comprehensive regulatory framework, by increasing the current statutory MBL limitation for experience, well-capitalized, and well-managed credit unions.

When regulated consistent with the principles of sound risk management and consistent with the capabilities of the credit union, increased business lending is good not only for the credit union, but also for its members and the communities in which the credit union operates.

NCUA has a long-standing history of effectively balancing the risks inherent in member business lending within an appropriate level of flexibility for credit unions to meet the business needs of their members. Over the two-and-a-half decades since NCUA issued its first MBL rule, the agency has made appropriate adjustments to keep pace with developments in this line of business.

NCUA is committed to remaining vigilant in carrying out its fiduciary responsibilities over the NCUSIF. Should Congress increase the MBL limit for credit unions by enacting H.R. 1418 or similar legislation, NCUA will ensure its prudential regulatory framework is further enhanced to manage the associated risks. In sum, NCUA will continue to fulfill its primary responsibilities: to protect the NCUSIF and the 91 million consumers who place their trust in credit unions.