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Testimony
of

O. William Cheney
President and Chief Executive Officer
Credit Union National Association

Before the
United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
and the
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on
H.R. 1697 – The Communities First Act

November 16, 2011

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Chairman Capito, Chairman Garrett, Ranking Member Maloney, and Ranking Member Waters, thank you very much for the opportunity to testify at today's hearing. I am very pleased to present the views of the Credit Union National Association (CUNA) regarding H.R. 1697, the *Communities First Act*.

Credit unions and community banks are different in many ways, and our view of regulatory relief legislation for community banks is just another example of our differences. Unlike the banks' view of credit union legislation, we do not reflexively oppose their regulatory relief bill. In fact, while there are several provisions with which we have significant concern, we are supportive of several of the provisions which would also provide regulatory relief to credit unions.

We encourage Congress to thoroughly examine each provision of H.R. 1697 to ensure that the changes are consistent with the best interest of public policy. We also call on Congress to enact a well-balanced bill that provides meaningful regulatory relief for credit unions and community banks, including provisions from this bill as well as H.R. 1418, which would allow well-capitalized credit unions with business lending experience, which are at or close to the credit union member business lending cap, to lend in excess of the cap. The combination of the proposals of both of these bills should be embraced by all who serve businesses on Main Street.

In communities across the country, credit unions and community banks operate side-by-side to meet the financial services needs of consumers and small businesses. In most cases, they peacefully coexist. In

fact, we hear regularly of community banks that have referred borrowers to credit unions, and credit unions which have referred members to community banks, in an effort to meet the needs of the community. We can get along and we know Congress wants us to get along.

Few issues have brought credit unions and community banks together like the recent battle over the regulation of debit interchange fees. While we strongly opposed this provision of the Dodd-Frank Act, we continue to work with the payment card networks to ensure that the exemption for small issuers that Congress provided proves meaningful.

Although we expect the debit interchange regulation to negatively impact credit union bottom lines over time, one of the immediate positive impacts of this regulation – for community banks and credit unions, alike – has been resurgence in consumer affinity to local financial institutions. Community banks and credit unions have welcomed the opportunity to serve those frustrated by the ever-increasing fees charged by the largest banks.

In the lead-up to the recent "Bank Transfer Day," credit unions and community banks in Santa Cruz, California worked together to make sure consumers in their area knew they had choices other than the largest banks. As a part of my written testimony, I have attached an advertisement that Bay Federal Credit Union, Lighthouse Bank, Santa Cruz County Bank, and Santa Cruz County Community Credit Union placed in a local paper encouraging consumers to keep their money local. (See Attachment A).

This represents credit unions and community banks at their best.

Another area where credit unions and community banks should agree and work together is in the pursuit of regulatory relief legislation. Unfortunately, whenever credit unions propose legislation intended to reduce our regulatory burden, it is almost always reflexively opposed by the community banks. They mislead Congress with misinformation regarding the credit union charter and mission. They try to leverage the credit union tax status to prevent new credit union powers, ignoring the fact that Congress has provided and reaffirmed this tax status based on the ownership structure and not-for-profit nature of credit unions. They denigrate credit unions' ability to provide financial services to credit union

members on a safe and sound basis when in fact the credit union safety and soundness record compares very favorably with that of banks.

The banks' opposition to credit union legislation has meant that hundreds of thousands of jobs that could have been created through additional credit union business lending have gone uncreated. Their opposition to legislation allowing more credit unions to serve underserved areas has meant that many Americans have gone without convenient and affordable financial services. Their opposition to legislation providing credit unions access to alternative forms of capital has constricted credit unions' ability to grow and better serve their members. When banks oppose credit union legislation, their shareholders may win, but consumers and small businesses lose.

Frankly, community-based institutions need to be able to spend more time and resources serving their members or customers and less time complying with burdensome regulations that have been the result of negligence and misdeeds perpetrated by the largest banks or unregulated financial services providers. We did not cause the problem, but the solution to the problem all too often includes our institutions and imposes disproportionate burdens.

H.R. 1697, the *Communities First Act*, would provide significant regulatory relief to America's community banks, and expand the ability of certain banks to incorporate under Subchapter S of the Internal Revenue Code. Our analysis of the legislation is divided into three categories: provisions that CUNA supports; provisions that Congress should amend to provide parity for credit unions; and provisions that expand the tax advantages for banks organized under Subchapter S of the Internal Revenue Code.

CUNA supports the following provisions of H.R. 1697:

- Section 107. FSOC review of Bureau Regulations. This provision would authorize the Financial Stability Oversight Council (FSOC) to set aside a final regulation prescribed by the Bureau of Consumer Financial Protection (CFPB) if the FSOC decides that it would be inconsistent with the safe and sound operation of U.S. financial institutions, or could adversely impact disproportionately a subset of the banking industry. CUNA has supported a similar provision in

H.R. 1315, the Consumer Financial Protection Safety and Soundness Act. At a hearing on H.R. 1315 earlier this year, CUNA suggested that the FSOC be authorized to set aside a CFPB rule if it determined the rule was "inconsistent with the safe and sound operation of United States financial institutions."[1]

- Section 201. Escrow Requirements. This provision would amend the *Truth in Lending Act* (TILA) to instruct the Federal Reserve Board to exempt from escrow or impound account requirements any covered loan secured by a first lien on a consumer's principal dwelling, if the loan is held by a creditor with assets of $10 billion or less. CUNA supports this provision, which would apply to credit unions and community banks.

- Section 202. Exception to annual privacy notice requirement under the *Gramm-Leach-Bliley Act*. This provision would amend the *Gramm-Leach-Bliley Act* to exempt certain financial institutions from furnishing a mandatory annual privacy notice. CUNA supports this provision, which would apply to credit unions and community banks.

- Section 203. Fees for agricultural loans. This provision would amend the *Consolidated Farm and Rural Development Act* to authorize the Secretary of Agriculture to: (1) assess, for agriculture loans under $5 million, a one-time fee of 1% or less of the loan's guaranteed principal; and (2) establish a preferred certified lender's program for specified lenders. CUNA supports this provision, which would lower guarantee fees on farm loans; it would benefit credit union members as well as bank customers, and could encourage additional farm lending.

- Section 204. Reimbursement for production of mandated records. This provision would amend the *Right to Financial Privacy Act of 1978* to provide that small financial institutions be reimbursed when they are required by federal law enforcement authorities to furnish records or data for investigative purposes. CUNA supports this provision, which will reduce the cost of compliance with data requests from federal law enforcement officials.

[1] Testimony of Rod Staatz on behalf of Credit Union National Association. House Committee on Financial Services. Subcommittee on Financial Institutions and Consumer Credit. Hearing on "Legislative Proposals to Improve the Consumer Financial Protection Bureau." April 6, 2011. 6.

- Section 207. Credit ratings. This provision would amend the *Dodd-Frank Wall Street Reform and Consumer Protection Act* regarding federal regulatory agencies' review of their reliance on credit ratings to direct them to require, in specified circumstances, that ratings-based determinations be confirmed by an analysis of the probability of a loss from holding an asset. CUNA supports this provision, which would allow financial institutions to continue to rely on external credit ratings and supplement them with information regarding the "analysis of the probability of loss" only if external credit ratings are not complete or there are heightened risks.

- Section 208. Small business data collection exclusion. This provision would amend the *Equal Credit Opportunity Act* to exempt certain small-sized businesses from a mandatory collection of business data. CUNA supports this provision which would exempt credit unions and community banks under $1 billion from the mandatory collection of business data under the Dodd-Frank Act.

- Section 301, related to reduced rate and deferral of income recognition on long-term certificates of deposit, and Section 305, related to young savers' accounts, are provisions that would not directly impact credit unions' provision of financial services to their members, but would benefit members that use these services. We are supportive of both provisions.

CUNA suggests that the following provision be amended to provide credit unions with parity under the law.

- Section 101. Short form reports of condition for certain community banks. This provision would permit qualifying community banks under $10 billion to submit a short-form of their quarterly disclosure to their regulator. This form is expected to be significantly and materially less burdensome than the current quarterly form, while at the same time providing sufficient material information for the regulator to assure the safety and soundness of the bank. If Congress determines that it is in the best interest of public policy for the vast majority of community banks to file quarterly reports with their regulator that are significantly less burdensome than they do under current law, we would encourage Congress to likewise direct the

National Credit Union Administration to develop a similar short form for similarly qualifying credit unions.

H.R. 1697 also includes several provisions designed to enhance the tax status for banks organized under Subchapter S of the Internal Revenue Code.

One provision (Section 501) would double the maximum number of shareholders permitted under Subchapter S.

We do not oppose this change but point out that the hypocrisy of the bank lobby appears to have no end. While aggressively lobbying to increase the tax advantages of Subchapter S for banks, the banking industry also continues to actively lobby to impose additional taxes on credit unions, arguing that credit unions' federal income tax status provides a competitive advantage and that imposing additional taxes would "level the playing field."

Before making any change to "level the playing field," Congress should consider what that would mean and who that would benefit. The banks would have Congress believe that expanding the Subchapter S tax preference would reduce operating costs for these banks and make them better able to compete with credit unions. Where is their evidence that additional tax advantages to banks would result in lower fees, lower rates or better service for consumers?

Our examination of Subchapter S bank financial results for 2010 and for the first half of 2011 shows that these banks recorded depositor fees as a percent of average assets that were nearly two-thirds higher than the fees at other similar-sized non-Subchapter S banks. At the same time, Subchapter S banks recorded earnings (ROA) that were roughly three times higher than similarly-sized C corporation commercial banks. For example, the Subchapter S bank average ROA (annualized) was 1.22% in the first half of 2011 while non-Subchapter S banks with less than $1 billion in assets earned 0.40%. Subchapter S bank cash dividends as a percent of assets averaged approximately four times higher than those at peer banks.

Subchapter S banks charge higher fees for consumers, have higher return on assets, and pay higher dividends to their shareholders than C-corp banks. In other words, these banks do not use their preferential tax treatment to better compete with credit unions. If indeed the credit union tax exemption created undue competition for banks, these Subchapter S banks would use their tax preference to lower rates and fees to their customers. The proposal before Congress would expand eligibility to this class.

When considering whether expanded Subchapter S authority is in the best public policy interest, Congress should consider who would benefit: consumers or bank shareholders? We strongly believe any savings should be passed along to consumers. Unfortunately, past performance of Subchapter S banks and their for-profit structure suggests that the most likely beneficiaries will be the banks' shareholders.

Another provision (Section 502) would permit Subchapter S banks to issue preferred stock. Current law only allows Subchapter S banks to have one class of stock outstanding. In previous testimony before Congress, the Independent Community Bankers of America (ICBA) has indicated that the driving factors behind its support for this provision are the constraints on growth that the current capital structure presents and the minimum capital ratios necessary to be well-capitalized for regulatory purposes.[2]

These concerns are familiar to credit unions, which face even more stringent capital restrictions and requirements than Subchapter S banks. The *Federal Credit Union Act* contains a statutory requirement that credit unions must maintain a net worth ratio of 7% in order to be considered well-capitalized; in addition, credit unions must meet certain risk-based capital requirements set by the National Credit Union Administration. Only the retained earnings of the credit union are considered capital for this purpose.

The ICBA says that the Subchapter S capital restrictions "prevent small community banks from having access to an important source of capital vital to the economic health and stability of the bank and the

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[2] Testimony of Cynthia Blankenship on behalf of the Independent Community Bankers of America. House Committee on Small Business. Subcommittee on Finance and Tax. Hearing on "S-Corps: Recommended Reforms That Promote Parity, Growth and Development for Small Businesses." June 18, 2008. 4.

community it serves."[3] A similar statement could be made regarding the capital restrictions contained in the *Federal Credit Union Act*.

If there is one lesson from the financial crisis, it is that capital is king. Financial institutions should be encouraged to have appropriate levels of capital and should have enhanced access to supplemental forms of capital. As the ICBA argument demonstrates, the tax treatment of a group of financial institutions should not hinder the ability of those institutions to acquire sufficient capital. Should this legislation move forward, we encourage Congress to consider provisions that would permit credit unions additional access to capital, and we would be happy to work with you toward this end.

Congress Should Consider Other Regulatory Burden Proposals

- ATM Fee Disclosure – The *Electronic Fund Transfer Act* requires financial institutions to display a physical **and** electronic disclosure of fees on automatic teller machines. The physical disclosure requirement is antiquated, dating back to a time before all ATM machines were able to provide electronic disclosures of fees. We have heard from several credit unions victimized by vandals or other individuals who remove the physical disclosure from the ATM, take a picture of the ATM, and then sue the credit union for noncompliance with the EFTA. We certainly appreciate Chairman Bachus' recent letter to the Consumer Financial Protection Bureau regarding this issue. We also support a legislative remedy. We encourage the Committee to investigate this issue and would like to work with you to secure a remedy that provides consumers with the important disclosure, but protects credit unions and community banks from outrageous and contrived lawsuits.

- Office of Regulatory Burden Monitoring – CUNA has encouraged the Consumer Financial Protection Bureau to create an Office of Regulatory Burden Monitoring to work with credit unions and community banks to assess the impact of regulatory burdens being imposed on these institutions and to coordinate with their prudential regulators. If the Bureau does not create such an office, we encourage Congress to consider directing the Bureau to do so.

[3] Ibid.

Regulatory Relief for Community-Based Financial Institutions Should Be Balanced

Make no mistake: credit unions support regulatory relief for all financial institutions -- community banks and credit unions alike. However, we strongly believe that legislation providing regulatory relief should be balanced so that credit unions and community banks both see benefit in terms of their ability to serve their members or their customers.

As part of well-balanced regulatory relief legislation, credit unions would expect the inclusion of language to permit well-capitalized credit unions, with business lending experience, that are operating near the statutory cap on credit union business lending to perform additional lending. This would allow qualifying credit unions to serve their local communities and small business owning members even better.

Representatives Ed Royce and Carolyn McCarthy have introduced a bill to this effect in the House of Representatives (H.R. 1418), and it has over 100 bi-partisan cosponsors. In October, the Subcommittee on Financial Institutions and Consumer Credit held a hearing on this legislation. Several members of the Subcommittee asked questions focusing on the demand for small business lending and the need for legislation to increase the credit union member business lending cap. While these topics were covered in depth at the hearing, we sent Chairman Capito a letter following the hearing that goes into greater detail with respect to the demand that exists in the market and the need for this legislation from the credit union perspective. I have attached a copy of this letter to this testimony (See Attachment B).

As we point out in the letter, the legislation that Representatives Royce and McCarthy have introduced would not harm community banks or the banking sector as a whole. It is not a zero-sum game, as one witness at the October 12 hearing incorrectly suggested.

Even if credit unions doubled the amount of business lending they do, banks would still have 90% or more of the commercial lending market in the country. The Royce-McCarthy legislation includes safeguards to ensure that the additional business lending would not jeopardize the credit union system. Additional business lending in a community helps everyone – banks, small businesses and credit unions.

This legislation would provide much-needed assistance and relief to the small business sector that is struggling. It would help create 140,000 jobs in the first year at no cost to taxpayers.

Conclusion

Credit unions and community banks both play an important role in their communities. Both served their constituencies well during the financial crisis. Both face a crisis of creeping complexity related to regulatory burden. Both deserve meaningful and balanced regulatory relief. However, we do not believe that H.R. 1697, in its current form, provides balanced regulatory relief to credit unions and community banks; therefore, we cannot support it at this time.

Further, credit unions across the country firmly believe that this legislation, or the provisions contained therein, must not move through Congress without similarly effective regulatory relief legislation for credit unions. We urge Congress to combine this legislation with H.R. 1418, the Small Business Lending Enhancement Act, and consider the other modifications we have suggested in this testimony. At such time as there is meaningful legislation before Congress providing meaningful and balanced regulatory relief for both credit unions and community banks, we will gladly support that measure. This is a key issue for America’s credit unions.

On behalf of America’s credit unions and their 93 million members, thank you for the opportunity to testify at today's hearing. I am pleased to answer any questions the Members of the Subcommittees may have.

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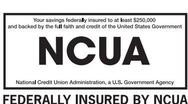

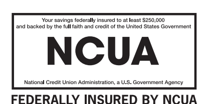

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October 26, 2011

The Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Capito:

On behalf of the Credit Union National Association (CUNA), I wanted to thank you for holding the hearing earlier this month on H.R. 1418, the Small Business Lending Enhancement Act. This legislation is critical job creation legislation which would permit credit unions to lend an additional $13 billion to small businesses in the first year, helping them create over 140,000 new jobs. We appreciated the opportunity to present testimony in support of this legislation and look forward to working with you to move the bill through the legislative process.

At the hearing, several Members, including you, raised questions related to the demand for this legislation. These questions focused both on whether there was enough available small business credit as well as whether there was a need to increase the credit union business lending cap in order to make additional credit available. Some also expressed concern that increasing the member business lending cap would lead to a reduction of bank business lending. I wanted to take the opportunity to address these questions.

Demand for and Availability of Small Business Credit

There is no doubt that there has been a reduction in the demand for business credit as a result of the recession. However, unlike the consumer sector, there is no indication that the small business sector is (or has been) engaged in a process of systemic deleveraging. On the contrary, there is a large body of evidence that confirms a healthy demand for loans as discussed in more detail below.

At the same time, there also is considerable evidence that a significant contraction in the supply of bank business credit has contributed to a reduction in business credit outstanding. Small businesses want credit but far too many cannot obtain the capital they need from the nation's banks. The record is clear: a lack of more robust small business borrowing, business expansion and job growth can be traced in large part to ongoing reductions in lending activity among the nation's commercial banks.

Since mid-2009, no fewer than 25 Congressional hearings have been held to discuss issues related to small business access to credit. Further, credit availability was a major driver behind the enactment of the Small Business Jobs Act of 2010, which

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created the Small Business Lending Fund (SBLF), a $30 billion taxpayer funded incentive to community banks to lend to small businesses.[1]

The importance of access to credit for small businesses was clearly articulated by a witness advocating for the enactment of the SBLF in 2010.

> "The Wall Street meltdown of fall 2008 and the ensuing credit crisis and recession hit small businesses harder than medium and large-size businesses because they have faced greater challenges in obtaining credit. Boosting the flow of credit will help the small business sector to lead the recovery of economic growth and employment… small businesses responded to the recession by laying off more workers than medium and large size businesses. The difference lies in access to credit. Small businesses are more dependent on bank credit than medium and large businesses. Medium and large businesses regained access to credit through the corporate bond market, while small businesses continue to suffer from lack of credit… The greatest potential for job creation is among small business with restored access to credit."[2]

There is considerable evidence suggesting not only that there is unmet demand for small business lending, but also that small businesses that would otherwise be interested in pursuing credit are not doing so because of the perception that credit is difficult to get in this economic environment.

In testimony before the House Small Business Committee earlier this year, the International Franchise Association, whose membership, according to their website, employs 6% of Americans, stated:

> "While we estimate that franchise businesses will be able to access $8.4 billion in lending this year, this analysis also shows that we will face a $2 billion shortfall in available loans. This shortfall will result in the loss of nearly 8,000 franchise unit transactions, both new business development and transfers, and a loss of more than 82,000 jobs and $10.7 billion in annual economic output."[3]

The National Association of the Self-Employed testified before the Senate Small Business Committee in May that, "Access to capital also continues to be a large

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[1] Credit unions did not need and did not seek access to this fund because the chief impediment to credit union small business lending is neither liquidity nor capital. It is the statutory cap on business lending.

[2] Testimony of James D. MacPhee on behalf of the Independent Community Bankers of America before the House Committee on Financial Services Hearing on "Initiatives to Promote Small Business Lending, Jobs and Economic Growth." May 18, 2010. 2.

[3] Testimony of William G. Hall on behalf of the International Franchise Association before the House Committee on Small Business Hearing on "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs?" June 1, 2011. 4.

problem for the self-employed and microbusinesses, despite efforts by the federal government to spur lending to small businesses."[4]

As noted in our written testimony, the Pepperdine Capital Markets Project conducts on ongoing, twice-yearly survey of U.S. small businesses in conjunction with Dunn and Bradstreet. While the second 2011 full report has not yet been published 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 of small businesses sought a bank loan in the preceding 12 month period. Among those that sought bank financing fully 57% indicated that they were not successful in obtaining financing. This is a clear indication that a substantial number of small businesses continue to need more access to capital.[5]

The most-recently published full report from the Pepperdine Project (Survey Report V – Summer 2011) is attached.[6] The Report – summarizes views of 1,221 privately-held businesses that responded to the survey. Among these, 24% had businesses that involved manufacturing and 11% were in the engineering and construction industry. Approximately 59% of respondents have between 11 and 100 employees.

One of the report's key findings was: **"Business owners enthusiastic about growing, but lack resources.** Nearly 95% of privately-held businesses owners report having the enthusiasm to execute growth strategies, yet just 53% report having the necessary financial resources to successfully execute growth strategies."[7]

Given this reported enthusiasm for growing it is not surprising that the report also finds substantial demand for financing on the part of small businesses: Overall, 38% of businesses indicated that they are "currently" seeking financing, with about one-half (48%) of these seeking bank loans.[8] In fact, bankers tell the Pepperdine researchers the same story being told by small business- and one that is disturbingly at odds with what banks been telling policy makers: Overall, 65% of banks responding to the Capital Markets Project Survey tell researchers that they have seen an increase in demand for small business loans compared to six months ago.[9]

On the supply side of the equation, the bank lobby has been telling policymakers that there is an ample supply of business credit. But they provide a starkly contrasting view in the Pepperdine Survey. Indeed the Report states: "Currently, lenders see economic uncertainty (48.6%) and access to capital (25.7%) as the top issues facing privately-held businesses".[10] Yet, despite their public claims to the contrary, bankers reveal to the Pepperdine researchers that they are restricting the supply of credit.

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[4] Testimony of Kristie Arslan on behalf of the National Association for Self-Employed before the Senate Committee on Small Business and Entrepreneurship Hearing on "Small Business Recovery: Progress Report on Small Business Jobs Act of 2010 Implementation." May 19, 2011. 5.

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

[6] Pepperdine Private Capital Markets Project Survey Report V. Summer 2011.

[7] Ibid. p.8

[8] Ibid. p.19.

[9] Ibid. p. 119.

[10] Ibid. p.111.

Overall, bank survey respondents indicate they are declining 60% of small business loan applications.[11]

Importantly, bank credit restriction in the face of healthy demand has been an ongoing problem. A 2010 Business Week article, *Why Small Business Can't Get Financing*, contains an extensive interview with John Paglia, senior researcher for the Pepperdine Private Capital Markets Survey. In the course of the interview Paglia states: "The No. 1 concern for private companies is access to capital. Nearly 31 percent cited that…" and "The companies also reported, by 71 percent, that if they had additional growth capital they believed they would see an increase in revenue growth." [12]

During the course of the interview, Business Week reporter Karen Klein states "Many bankers say they aren't lending, at least in part, because demand for loans is down. But your survey seems to contradict that assertion." Paglia's response is noteworthy: "Generally speaking, we found more demand for loans among business owners. And among the banks that responded to our survey, 72 percent indicated that the number of loan applications they received had increased during the last six months. So there's demand for capital. Something's not quite sitting right when we hear from the banks that there's no demand." [13]

The National Small Business Association's 2011 Mid-Year Economic Report found that lack of available capital was a concern for 22% of those responding to their survey of small business owners.[14]

According to the National Association of Realtors®, 87% of Realtors® said that lack of financing impacted their clients decisions in 2011; nearly 60% said that they failed to complete a transaction due to financing; and lack of available financing was the most frequent response of Realtors® when asked what were the major obstacles to commercial real estate this year. Sixty-five percent report significantly or somewhat significantly tightening of lending conditions; none reported a significant easement of lending conditions. The Realtors® report further states, "While large corporations do not have difficulties securing capital, small businesses have been struggling to find access to financing."[15]

Some small business owners may have simply given up on the credit market. Multifunding.com, a small business finance consulting organization, conducted a survey of 1200 small businesses in July 2011 and found that 73% of small business owners who say they are in need of a loan have not applied for a loan. Twenty-one

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[11] Ibid. p.118.
[12] Klein, Karen E., "Why Business Can't Get Financing." Business Week. August 31, 2010.
[13] Ibid.
[14] National Small Business Association. "2011 Mid-Year Economic Report". Page 8. August 3, 2011. See: http://nsba.biz/surveys.shtml.)
[15] National Association of Realtors® Research. August 2011. 1.

percent said they were afraid of application rejection; 18% said they were not willing to pay high interest rates.[16]

According to Gallup, 30% of small business owners say it is difficult for them to obtain credit – two to three times more difficult than it was in 2006 and 2007; 21% say credit is easy to get, which is about half the number from 2006 and 2007.[17]

The demand for small business loans is present in the market and the data suggest that banks continue to constrict credit availability while credit unions are expanding their business loan portfolios. 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.

Why Increasing the Credit Union Member Business Lending Cap Is Necessary

Another question that you and other members of the subcommittee raised at the hearing was whether it is necessary for Congress to permit qualifying credit unions to lend to business owning members in excess of the statutory cap in order for credit unions to continue to meet the business lending needs of their members. We believe that it is.

The recently strong growth of credit union business lending is slowing as an increasing number of credit unions approach the cap, and the support credit unions have provided to America's small businesses cannot continue into the future unless Congress raises the credit union business lending cap.

The bank lobby claims that only a "handful" of credit unions are actually capped, but a total of more than 500 credit unions will be bumping up against the cap in the next three years. Contrary to the bank lobby claims that the credit unions constrained by the cap are a "new breed" of large credit unions, it is worth noting that a credit union seeking to offer business services to its members is not engaging in activity that is "new" to credit unions – credit unions have been offering business services to their members since they were founded in the United States over 100 years ago. In addition, roughly 75% of the over 500 credit unions that are constrained by or at the cap have total assets of $500 million or less, rendering the bank lobby's assertion that these are only large credit unions false.

Most of these credit unions are already looking for ways to moderate their business loan growth.

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[16] Multifunding.com. August 11, 2011. (see: http://www.multifunding.com/uncategorized/multifunding%e2%80%99s-second-quarterly-small-small-businesses-arent-applying-for-loans/ .)

[17] Testimony of Dennis Jacobe before the House Committee on Small Business Hearing on "Access to Capital: Can Small Businesses Access the Credit Necessary to Grow and Create Jobs." June 1, 2011. 3.

- 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 in these credit unions is contrasted, the cap limitations are clearly reflected in slower growth rates among credit unions that are closer to the cap. In fact, the aggregate data shows:

- 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.

As the economy hopefully recovers over the next few years, the business loan growth of this group of credit unions will disappear without an increase in the cap. In an environment where banks have constricted their lending, the credit constriction resulting from the statutory credit union business lending cap will mean that some members with existing business relationships may find it increasingly difficult to secure business credit from their credit union, and the credit unions which have contributed to business lending growth during the recession will be increasingly unable to serve new member business borrowers. All of this makes it critical that legislation to increase the business lending cap is enacted.

Increased Credit Union Business Lending is Not a Zero Sum Game for Banks

One of the more perplexing arguments made by the bank lobby is that Congress should not increase the cap because there is no excess demand for small business lending but that raising the cap would harm banks by allowing credit unions to take loans from them.

The bank lobby grossly misrepresents the impact of raising the credit union business lending cap on their own lending volumes. Research suggests that additional credit union business lending would not crowd out bank business lending. And certainly, with the banks controlling 95% of the commercial lending market, even a doubling of credit union market share would not significantly alter their dominance of this market.

During the hearing, one of the bank witnesses specifically claimed that that business lending is a "zero-sum game" – which, if true, would mean that every loan originated by a credit union is a loan that is not originated by a bank. This is simply not true.

Economic theory is revealing 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 were totally price inelastic, that increase in supply would 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.[18]

This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using their estimate, and considering that credit unions currently hold on average only about 5% of the small business loans held by depository institutions, and that H.R. 1418 would limit annual business loan growth above the old cap to 30%, if credit unions entered the market lowering interest rates by roughly 100 bp, the vast majority of that new lending could be accomplished without any reduction in bank loans.

In a recently published report for the Small Business Administration, Professor James A.Wilcox also dispels the zero-sum-game myth. While estimates in the Wilcox paper indicate that developments that boost small business loans at credit unions tended to reduce business loans at banks – the effect was very small. The evidence suggests that the offset was about $0.20 per dollar of additional small business loans at credit unions. In other words, a reduction in business loans at banks implies that a $1 increase in the supply of small business loans by credit unions would lead to a net increase in business loans of $0.80.[19] Put simply, on average, 80% of the increase in credit union lending is new capital that would otherwise not be available in the

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[18] 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. Page 18. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832.

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

marketplace. Thus, the vast majority of new credit union lending is not “siphoned” from banks that would otherwise make these loans.

Conclusion

Throughout our history, credit unions have existed to serve the credit needs of their members. From the very first days, this has included the business credit needs of members. During the recession, credit unions remained engaged in member service, and increased lending to small businesses when other lenders fled the market. The credit unions that contributed the most to this growth are or soon will be approaching the cap. In order for these credit unions to continue to serve their small business owning members, Congress must raise the statutory cap. Representatives Royce and McCarthy have put forward a thoughtful bill to achieve this that includes provisions designed to enhance safety and soundness. We urge you to strongly support this legislation, which would allow credit unions to lend an additional $13 billion in the first year, helping small businesses create 140,000 new jobs.

Again, we appreciate your holding the hearing on H.R. 1418, the Small Business Lending Enhancement Act. We look forward to working with you and your staff as this legislation moves forward.

Best regards,

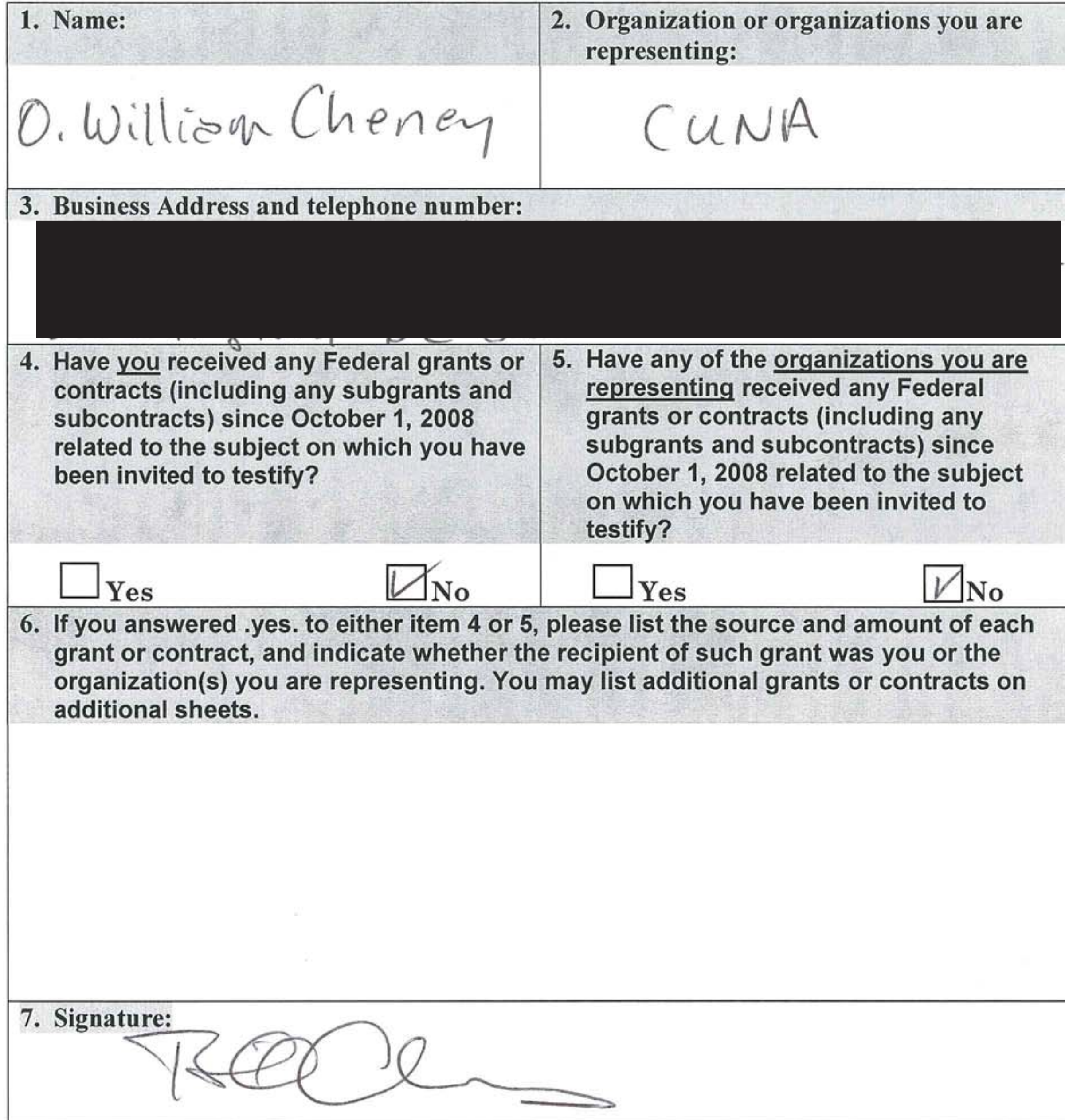
Bill Cheney
President & CEO

Attachment

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:
O. William Cheney	CUNA

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?	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	☐ 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.