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

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

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

Wednesday, October 12, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2128, Rayburn House Office Building, Hon. Shelley Moore Capito [chairwoman of the subcommittee] presiding.

Members present: Representatives Capito, Renacci, Royce, Manzullo, McHenry, McCotter, Pearce, Westmoreland, Luetkemeyer, Huizenga, Duffy, Canseco, Grimm, Fincher; Maloney, Hinojosa, McCarthy of New York, Baca, Scott, Meeks, and Carney.

Also present: Representative Sherman.

Chairwoman CAPITO. This hearing will come to order. I would like to inform members of the subcommittee that we are expecting a long series of votes, four votes, around 5 p.m., this evening. It is my intent to complete this hearing before we leave for votes, so I will ask Members and witnesses to adhere to the set time limit for statements and questions so all Members who are present can ask questions. I appreciate everybody's cooperation, which I am sure I will get.

First of all, I would like to thank Mr. Royce for his leadership in offering the legislation before the subcommittee today. He has long been a champion for providing regulatory relief for credit unions, and I commend him for his efforts.

Credit unions across the country serve many different populations. The Federal charter for credit unions was created by the Federal Credit Union Act of 1934, and since then, credit unions have grown across the Nation, serving members through either a single common bond, multiple common bonds, or through community credit unions which are limited to a specific geographic region.

There are currently 7,950 credit unions across the Nation, serving 90 million members, with nearly $679 billion of deposits. These institutions primarily serve consumer credit needs of their members, but some credit unions do engage in business lending for their members.

The Credit Union Membership Access Act of 1998 limits the credit union's aggregate member business lending to the lesser of 1.75 times the credit union's net worth, or 12.25 percent of the credit union's total assets. The legislation before the subcommittee seeks to raise this cap to 27.5 for credit unions who meet specific criteria.

I look forward to our witnesses' testimony on the merits of this proposal. I am specifically interested in learning more about the breadth of credit unions involved in member business lending, why more credit unions are not currently involved in member business lending, and the cost and benefits of increasing the cap on credit union member business lending.

I would like to thank our witnesses for participating in this afternoon's hearing and I look forward to the testimony. I would now like to recognize our ranking member, the gentlelady from New York, Mrs. Maloney, for the purpose of making an opening statement.

Mrs. MALONEY. I want to thank the chairwoman for calling this important hearing. This is an issue that I look forward to learning more about, and I also want to welcome you, Chairwoman Matz, and thank you for being here.

Credit unions are a vital element of our financial system. They provide critical financial services to their members, and I am privileged to represent a number of thriving credit unions in my district which serve unique populations. United Nations Federal Credit Union serves the employees of the United Nations across the world in some areas where there are no financial institutions. The entertainment industries—the Actors Federal Credit Union—to name a few, and just this past year, the first credit union to be created in New York in 60 years was created in my district at the Queens Bridge Houses, the largest public housing project in the City of New York.

Member business lending is a service that credit unions provide to their small businesses. The average loan size is about $220,000, and credit union business lending has a slightly lower delinquency rate than FDIC-insured institutions lending to small businesses, according to one report that I read.

In my State, there are 111 credit unions that offer member business lending, often in underserved neighborhoods where there are no other financial services. And I have heard from many of them that raising the cap—which they support—on credit unions has the potential to put out more liquidity, employ more people, and help more projects go forward. This sounds encouraging, yet financial institutions and community banks have grave concerns about raising the cap.

They argue that raising the cap would give credit unions an unfair advantage over banks because credit unions serve special underserved areas, and enjoy a special tax status that banks do not have. Some banks state that this increased activity would allow them to deviate from their mission of serving members of modest means and makes them functionally equivalent to banks. They also argue that few credit unions are near the cap, and the ones that do engage in member business lending do not have the expertise to lend to this segment in a safe and sound manner.

These are some of the issues that I hope we can explore today. I look forward to learning more about this issue. I expect a lively discussion, and I know that the banks in my district and the credit unions in my district are deeply divided over this issue. So I look forward to the witnesses and I look forward to the debate and I look forward to exploring this issue more.

I congratulate all of the Members who have worked hard on this issue for many years, and I yield back the balance of my time.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Royce for 2 minutes for the purpose of making an opening statement.

Mr. ROYCE. Thank you, Madam Chairwoman. Let me explain the intent of the bill. It is to expand access to credit for creditworthy borrowers. And I think if you look at the New York Federal Reserve study in October, they say that three-quarters of small businesses looking for credit in the summer of 2010 were turned down or received only some of the financing that they requested. Three-quarters. And then you have the Wall Street Journal story, smaller businesses seeking loans still come up empty, and that story cites an 8.6 percent drop from last year in terms of the business lending.

Also, I want to point out that unlike previous versions of this bill, this is not a blanket increase in the member business lending cap. In order to qualify, a credit union must be well-capitalized. It must have at least a 5-year history of sound member business lending experience. It must be operating near the cap for at least a year, and it must receive the approval of their regulator, the NCUA.

It is also worth noting that this plan differs from other proposals we see from the government because, whether it was a trillion dollar stimulus bill that failed to meet expectations or the recently created Small Business Lending Fund (SBLF) program, I just want to point out that the Journal reported that of the $4 billion disbursed by Treasury through SBLF, over half has come back to the Treasury in the form of TARP repayments. One participant even labeled it a shell game.

So what this does is it allows us, without borrowing the money, the ability to free up capital that is currently sitting on the sidelines, and economists say it will allow up to $13 billion to be lent to small businesses, which in turn could create 140,000 jobs.

In closing, I don't believe this legislation will be a cure-all, but I do believe it is an idea worth considering given the current state of the economy. In the way we have crafted the bill, I would urge its support. Thank you.

Chairwoman CAPITO. Thank you, Mr. Royce.

I would like to recognize Mrs. McCarthy for 2 minutes for the purpose of making an opening statement.

Mrs. MCCARTHY OF NEW YORK. I would like to thank Chairwoman Capito and Ranking Member Maloney for holding this hearing on H.R. 1418, the Small Business Lending Enhancement Act, companion to a Senate bill introduced by Senators Udall and Snowe.

I believe all my colleagues will agree that we need to promote initiatives that will spur job growth and move us further towards our efforts towards the economy. In doing so, we must look at ways to provide business growth and access to credit, especially for our small business community hit the hardest by the financial crisis. Small businesses are the engine of our Nation's economy, and by enhancing their access to credit and lending opportunities, jobs will be created.

The legislation before us today will enable credit unions to further assist American small businesses to increase their member business lending authority only after meeting certain qualifying criteria, as my colleague Mr. Royce has said. We must do all we can to promote economic growth and job creation, and this bipartisan, bicameral legislation provides an opportunity for credit unions to fill the lending void for our small business community.

This is something that certainly I think is worth exploring. It is certainly something I support. With that, I yield back the balance of my time.

Chairwoman CAPITO. The gentlelady yields back.

Next, I would like to recognize Mr. Westmoreland for 1 minute for the purpose of making an opening statement.

Mr. WESTMORELAND. Thank you, Chairwoman Capito, for yielding and for holding this hearing.

Credit unions are a vital part of our Nation's financial sector. They serve their members well and are in touch with their local communities. I belong to a credit union. They are good people. Right now, the most important thing credit unions and banks can do, however, is to work together. They can and must find common ground. Neither one of these groups are going to get the reforms that they need with the other standing in the way.

I encourage the witnesses here today in both industries to look at themselves and identify their priorities, identify the common ground, and work for compromise that will help both industries create jobs and get more money into the hands of small businesses.

Additionally, I want to charge the National Credit Union Administration and all the banking regulators to work to take a hard look at all their regulations and see where changes can be made to encourage financial institutions to lend. After all, putting capital into the hands of entrepreneurs and business owners, large and small, is the only way to get our economy back on track and get more Americans back to work.

Thank you, Madam Chairwoman, and I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Hinojosa for 2 minutes for the purpose of making an opening statement.

Mr. HINOJOSA. Thank you. Chairwoman Capito, thank you for holding this important and timely hearing today as our Nation continues to climb out of the worst economic recession since the Great Depression. New Federal laws and regulations are changing the structure and face of the financial services industry. Today, however, Members of Congress on this subcommittee turn our attention one more time to debate whether it is wise to increase credit unions' commercial lending limit from 12.25 percent of their assets to 27.5 percent of their assets. I doubt that such a change would help improve our economy and that credit unions have the capital to engage in complex commercial lending.

In 1998, Congress instituted a member business lending cap of 12.25 percent of assets in order to ensure credit unions stay focused on their mission of serving their membership. This is intended to allow credit unions to help their members start small businesses, as opposed to allowing credit unions to make complex and very large commercial loans.

A large number of credit unions remain undercapitalized. As of June 2011, 381 credit unions are on the NCUA's watch list, and five corporate credit unions are in conservatorship. Certain data coming across my desk indicates that approximately 6,900 community banks are adequately capitalized and could make, but apparently are not making, commercial loans. If community banks are unable or unwilling to make commercial loans at this time, why should we believe that credit unions can make up the difference when, as noted, over 381 of them are on the watch list?

I realize that many will disagree with my statements. I welcome a productive dialogue on the commercial lending limit currently imposed on credit unions and legislation that would increase it from 12.25 percent of assets to 27.5 percent of assets.

And with that, Chairwoman Capito, I yield back the remainder of my time.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Luetkemeyer for 2 minutes for the purpose of an opening statement.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Today, we are examining legislation that would more than double a credit union's ability to make business loans, despite the fact that there are presently few credit unions that engage in member business lending, and even fewer that are at the current 12.25 percent cap.

Also, an interesting fact to be aware of in this discussion is that between 2008 and September 2010, member credit unions that offered business loan products actually decreased from 1,942 to 1,758, an almost 10 percent drop.

History tells us that Congress enacted limits on credit union business lending in 1998 in order to ensure the safety and soundness of the credit union industry and to maintain their focus on their lending mission. As we know, credit unions enjoy a more favorable tax status than banks and are required to comply with different, and in some cases less onerous regulations. Each has its own niche to service. Each has its own set of rules.

The question then is, do credit unions really need to get out of their niche? In my discussion with credit unions in my State, it would appear that a few big national credit unions are pushing for this expansion, while the rest really aren't all that interested. Many of those largest credit unions are bigger and more complex than the average community bank or credit union in Missouri. It kind of reminds me of the difference in business models between Wall Street banks and the community banks.

I remain unconvinced that the issue at hand is truly one of access to credit, as there is plenty of capital and willingness to lend in the financial services industry, whether it lies in the fact that few businesses are interested in growing in this economic climate. Instead, they are hunkering down and trying to just survive because of the uncertainty caused by the punitive nature of our tax policy and regulatory policy.

Both the banks and the credit unions have a niche in the financial services industry that they serve. Both do a good job of servicing their customers in that niche. This bill, however, appears to me to be an effort by the credit union industry to try and move into another area without having to play by the same rules others in that niche have to play by, and that causes great concern for me.

Thank you, Madam Chairwoman. I yield back.

Chairwoman CAPITO. The gentleman yields back.

I would like to recognize Mr. Scott for 2 minutes for the purpose of making an opening statement.

Mr. SCOTT. Thank you, Madam Chairwoman.

This is, indeed, an important bill, but the fundamental question we have to ask ourselves up front is: What is in the best interests of the overall economy? What is in the best interest of small businesses especially?

We currently have a problem of getting money out and lending it to small businesses. Is this the sole domain of the banks? Do we need to expand the capacity of credit unions? I don't know the complete answer to that. Hopefully, we can get that answer today.

I think it would be a good point if we could determine and get our hands around an assessment of just how many small businesses have been turned away from banks and have been, as a result of that, received by the credit unions. I think we have to measure this very carefully. Both our banks and our credit unions are very important players in our economy, and I think when we make this decision on whether or not or how far to extend the capacity of credit unions in terms of their total assets in terms of their capacity of lending, the decision has to be made based on what is in the best interests of the consumer, what is in the best interest of small businesses, and what is in the best interest of creating jobs.

And I think in order to do that, we really have to get our hands around the entire issue. And the big question is, where have banks failed to respond to small businesses? It is important that we get that accurate information so that we can make the most accurate and the most intelligent decision as far as going forward with this bill, and I am interested in working on it. I am interested in asking the questions to get to the answer, and hopefully, I think, if we can get some good data to show that need, it will be very beneficial for both the banks and the credit unions, but most importantly, it will be a great benefit to our small business community.

With that, Madam Chairwoman, I yield back.

Chairwoman CAPITO. Thank you.

I would like to recognize Mr. Canseco for 1 minute for the purpose of making an opening statement.

Mr. CANSECO. Thank you, Madam Chairwoman.

If there is one thing to take away from the title on the focus of today's hearing, it is that lending to small businesses has been severely hampered in recent years, and the economy and our ability to create jobs is suffering as a result. As I travel the 23rd District of Texas and talk to banks, credit unions, and small businesses looking to grow, the one word I keep hearing is "uncertainty:" uncertainty over new rules; uncertainty over the economy; and uncertainty over our Nation's enormous debt.

It has become very clear that a large reason lending to small business is hurting right now is from an onslaught of regulation that has frightened or forbidden lenders from taking any risk. This is threatening the ability of consumers to choose from a vast array of financial services and products and lenders. It is a monumental problem which could be helped through regulatory relief for all types of lenders, especially those in small communities, and I look forward to hearing from today's panel on how we can help fix this problem.

Thank you, and I yield back.

Chairwoman CAPITO. Thank you.

That concludes our opening statements.

I would like to welcome our first panel, which has one special witness, and I would like to recognize you for the purpose of giving a 5-minute opening statement, the Honorable Deborah Matz, who is chairman of the National Credit Union Administration. Welcome.

STATEMENT OF THE HONORABLE DEBORAH MATZ, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

Ms. MATZ. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee.

I appreciate this opportunity to discuss credit union member business lending legislation, regulation, and supervision, and the significance for small businesses. As you may know, credit unions have always offered member business loans, even before the cap was imposed in 1998. Over time, this lending has evolved with the needs of entrepreneurs who deserve greater, not fewer, affordable credit options.

Today, credit unions have more than $36 billion in outstanding loans to member-owned businesses. Member business lending provides three tangible benefits:

First, it allows small businesses to obtain reasonably priced loans. Simply put, more competition benefits the marketplace and has positive effects on credit availability and costs.

Second, prudent member business lending diversifies a credit union's portfolio. This improves the ability to withstand economic cycles.

Third, member business lending supports communities. It spurs job growth and expands consumer access to goods and services.

As the prudential regulator, NCUA recognizes that member business lending poses unique risks and requires specialized oversight. In response, NCUA has tailored rules to emphasize sound underwriting, solid collateral, and tested management. These criteria form the foundation of prudent lending.

Like other loans, member business loan performance is cyclical. Recent trends reflect the economic downturn. Member business loan delinquencies stood at 53 basis points in 2006, peaked at 3.93 percent in 2010, and has since improved by 29 basis points. While delinquencies and charge-offs increased during the recent downturn, these increases primarily resulted from the severe decline in real estate values in the five sand States: Arizona; California; Florida; Nevada; and Utah.

Nationwide, more than 2,100 credit unions make member business loans. Such lending has increased by 44 percent since 2007 despite the downturn, but these statistics don't capture the fact that member business lending serves an important market segment: small businesses; and entrepreneurs.

On the whole, credit union loans are much smaller than other business lenders. The average member business loan is only $222,000. Of course, this average represents a wide range of loans for a variety of purposes. For example, credit union loans for commercial and industrial purposes, such as building or equipment, averaged just $128,000. Similar bank loans averaged more than five times larger. Credit unions are frequently the only lenders making small loans to expand an auto repair shop, start a day care center, or open a bodega. Member business loans also support local restaurant owners, farmers, and other self-employed entrepreneurs who may have nowhere else to turn for credit.

However, credit union member business lending is constrained by a cap. Currently, more than one in five credit unions making member business loans that are subject to the cap have reached 50 percent or more of this ceiling.

To expand credit union service to small businesses, Congressman Royce and Congresswoman McCarthy have proposed H.R. 1418. The bill's tiered approach would allow healthy, well-capitalized credit unions, meeting high standards, to increase lending in small, manageable increments. Authority to exceed the first tier would not be automatic. Credit unions would have to meet stringent standards that place a premium on a proven track record of successful management.

Let me assure you, if Congress increases the current cap, NCUA would promptly revise our regulations to ensure that these changes would not threaten credit union safety and soundness. NCUA would also remain vigilant in carrying out our supervisory authority. The proposed bill, together with our responsible regulatory approach, would allow credit unions to prudently grow their member business lending. In doing so, credit unions would diversify loan portfolios and reduce concentration risks. H.R. 1418 would require less than adequately capitalized credit unions to suspend business lending. This safeguard mirrors NCUA's current rule.

In sum, H.R. 1418 is a well-conceived, balanced approach to making more capital available to small businesses while ensuring that these loans are made prudently, and consistent with each credit union's abilities. Entrepreneurs work hard, take risks, and put people to work, but to fulfill their dreams, they need capital. Credit unions have long met these capital needs. It is discouraging to hear stories from well-managed, well-capitalized credit unions which have to turn away long-time member businesses because of the cap. H.R. 1418 would permit credit unions to empower more enterprising individuals and safely meet the needs of more small businesses that are expanding and creating jobs for their communities.

Thank you, and I look forward to your questions.

[The prepared statement of Ms. Matz can be found on page 95 of the appendix.]

Chairwoman CAPITO. Thank you very much.

And I will begin the questions.

Let me just, in point of clarification, I think you said in your statement that 2,100 credit unions are now doing member lending; is that correct?

Ms. MATZ. That is correct.

Chairwoman CAPITO. Okay. And then you said only one in five are over the 50 percent cap; is that correct?

Ms. MATZ. Yes.

Chairwoman CAPITO. And then you went on to say that they are turning down—that there are credit unions that are turning down—and you and I talked about this before. Would it be accurate to say that not many of these are up against the cap, or very few are up against the cap, and so I guess I am kind of wondering why the cap—what you think the cap would need to be raised to—if people aren't even pushing up against the cap that exists right now.

Ms. MATZ. The cap constrains all credit unions, those that are making business loans and those that haven't begun. Credit unions that haven't started making business loans, but want to, have told me that they don't do it because of the cap, because they don't want to make the significant investment in hiring commercial lenders and in purchasing the infrastructure if they are limited by a cap.

I recently had some credit union CEOs in my office. I asked them the question you just put to me, and I got some interesting responses. There was one credit union which has $220 million in assets. He is currently at only 25 percent of the cap. He has made $6 million in business loans, but he knows that he has only $18 million left. So he figures that in 3 years, he will be at his cap. He had a commercial lender who resigned, and he made the decision not to replace her because he feels that with 3 years left, he is not really going to be ramping up. He is going to be splitting the work between the remaining employees and not really generating a lot of new business. Mostly, he will try to fill the needs of existing members.

I heard something similar from someone who had a $100 million credit union. She also had $6 million in loans that she made, but her cap was a little over $12 million, and she said that she is now only making loans to existing members who have business loans and need additional loans for expansion, because she knows she is going to get near the cap and that she doesn't want to turn business away.

With all of this in mind, my impression is that the cap affects all credit unions that are making business loans or that want to make business loans.

Chairwoman CAPITO. Okay. Can a credit union loan to a nonmember—a business loan to a nonmember?

Ms. MATZ. No.

Chairwoman CAPITO. No, okay. So that doesn't happen. I didn't think so.

You also mentioned in your statement that member business lending had increased by more than 44 percent, and I believe Mr. Luetkemeyer in his statement or somebody mentioned that it was principally just the very, very large credit unions that are doing a lot of the business lending. Was a lot of that occurring in the larger credit unions, the increase in business lending over the last 4 years?

Ms. MATZ. The largest credit unions have the most capacity, but there are credit unions of all sizes making business loans, however more of them make loans if they are over $50 million, and certainly the larger they are, the more capacity they have to make business loans.

Chairwoman CAPITO. Right. To make the investment, because as you and I talked on the phone, they have to hire commercial lending specialists that can analyze the risk, etc.

Ms. MATZ. Right.

Chairwoman CAPITO. And the delinquency rate is low for member business lending at credit unions. Could you talk a little bit more about that? I know you said it had risen over the last several years, but if you could just expand on that?

Ms. MATZ. I wouldn't classify it as low, but it is trending down, and it is lower than the bank delinquency rate for comparable levels of delinquency, but I don't get all that concerned about delinquency because once you see the delinquency, we supervise it, we will get in and get the credit unions to manage it. Delinquencies don't necessarily result in charge-offs, and charge-offs don't necessarily result in losses if the loans were well-collateralized, and if they were underwritten well.

As you know, I look at delinquency as a trigger as to whether the credit union needs to change something about the way it is doing business, but it is not something that alarms me, and it is not necessarily related to their losses.

Chairwoman CAPITO. Are more—and you might have said this in your statement—credit unions entering the member business lending arena or exiting it right now, with this cap the way it is?

Ms. MATZ. It depends on the timeframe you are looking at, but we have had an increase over the past several years of credit unions making business loans.

Chairwoman CAPITO. Thank you. My time has expired. Mrs. Maloney?

Mrs. MALONEY. Thank you. Do credit union members have the ability to encourage or prevent their credit union from originating member business loans?

Ms. MATZ. No.

Mrs. MALONEY. They don't? So if this bill were to become law, how can NCUA, or your organization, ensure that the credit unions will continue to maintain prudent safety and soundness standards?

Ms. MATZ. If this becomes law, we will develop regulations that tier the increase. Under the proposed legislation, a credit union could increase their loans by 30 percent each year. We will probably develop some sort of tiering which gears the increase to certain levels of accomplishment.

We also have been looking at revising our member business rule to perhaps increase the experience level of the senior member business lending official. So we will develop stringent regulations to enforce the legislation and make sure that it is done safely.

Mrs. MALONEY. In your view, what are the most important reasons for Congress to consider this bill and pass it, the Small Business Lending Enhancement Act?

Ms. MATZ. It enhances safety and soundness because of the tiered approach. It permits credit unions to make loans and to make them in a safe and sound manner. It also fills a very important need in the community. I encourage credit unions to think about making business loans because it diversifies their portfolio. Credit union portfolios are made up almost exclusively of autos and mortgages, and often they are long-term, fixed-rate mortgages which have interest rate risk. So having a percentage of member business loans on their books diversifies their portfolios and that in itself is a safety and soundness measure.

In addition, they are filling a need in the community. As you know, these are very small loans. The average is $222,000, and it is sometimes difficult for small businesses to get that size loan from another financial institution.

Mrs. MALONEY. In your view, how many credit unions would meet the requirements listed in the bill and be eligible to lend up to the 27 percent of assets?

Ms. MATZ. Of the credit unions that are 80 percent or more, I think about half of them. I don't remember exactly, but I think about half of those that are up against the cap would immediately qualify to go above it, but I don't have the exact number.

Mrs. MALONEY. How does the credit union decide to go into lending business loans and to begin lending in that area? I know that many of my credit unions in underserved areas do not.

Ms. MATZ. It is really a business decision between the management and the credit union board of directors, if they have the need in their community, they feel that they can make the investment, they have enough capital, and they are well-managed enough and can get approval to start making the business loans. It is really an individual decision made by the board and the management.

Mrs. MALONEY. You mentioned, or it was in your testimony that raising the member business lending cap would increase diversity in the lending portfolio; is that correct?

Ms. MATZ. Yes.

Mrs. MALONEY. And why is that important?

Ms. MATZ. Because credit unions are concentrated in auto loans and mortgage loans, and a great many of these mortgage loans tend to be fixed-rate mortgage loans, so in that, there is interest rate risk. This is an opportunity to diversify their portfolio and get some of that interest rate risk off of their books.

Mrs. MALONEY. Thank you. My time has expired. Thank you for your testimony.

Ms. MATZ. Thank you.

Chairwoman CAPITO. Thank you. I would like to recognize Mr. Renacci for 5 minutes for questions.

Mr. RENACCI. Thank you, Madam Chairwoman, and thank you, Chairwoman Matz, for being here.

I am trying to get a handle on demand. What is the demand of small business loans? What is the demand—the community banks, when I talk to them, say there is not enough demand today, and the loans that they are seeing may not be as creditworthy as they are allowed to assume or finance.

So the question I would have for you is—and I know in your conclusion you said that this bill has the potential to increase the access of small businesses to capital, promote job growth, and diversify credit union portfolios. I agree with the third position. I am trying to get a handle on the first two. If the demand isn't there, where is the borrowing capacity that credit unions are looking for?

If the small community banks can't finance that loan, why are the credit unions able to do it?

Ms. MATZ. I am not in a position to address the community bank situation, but credit union member business lending has been going up, and since 2006 it has gone up by 44 percent. It has gone up even in this past year. So there is a demand for credit union loans and—

Mr. RENACCI. I am going to interrupt you there, but I am trying to get to that point. What type of loans—are these loans that the community banks aren't able to do?

Ms. MATZ. In some cases, they are. In some cases, I am told that credit unions have made loans that have not been made by banks, probably because of the size, because they are very small loans. They are not because of the risk quality of the loans, because the credit unions do good underwriting, but generally I believe it is because of the size.

But to the point that was made before by I think Mr. Westmoreland, I often hear from credit unions about credit unions and banks working together. I hear from so many credit unions that, aside from the squabbling on the national level, that in their communities they do work with the banks and that they send members to banks if they can't make the loan, and frequently the banks will send them members for loans that they feel they can't make. So I think there is some reciprocity actually in the communities.

Mr. RENACCI. I still am a little bit—and again, in your testimony, you said that it has increased 44 percent. Give me some examples. Give me five or six examples of credit unions, what they have lent to in the business community that maybe could not be handled by a community bank or a small community bank. Again, I am getting back to the demand situation.

Ms. MATZ. I don't know if these can or can't be handled by the community banks, but what I am told is that they might make loans to someone who is starting a day care or opening or expanding a restaurant or young people who might be starting some business in their community, small businesses generally in the community.

Mr. RENACCI. So you don't believe there is any chance that the creditworthiness is an issue; you think it is very similar from—

Ms. MATZ. Delinquency rates for credit unions are a little bit lower than they are for banks, so I don't believe that creditworthiness is the issue.

Mr. RENACCI. I know back in Ohio, in my district and also in the State, when I have talked to the credit unions—and I am a big supporter of all proponents. We have to get dollars back out to small business owners, but when I keep hearing small business owners cannot borrow money because of regulations and some of the overburden of regulations—I have personally seen options where the only way that a bank could lend money to a small business owner or to one of the businesses you have talked about, is they have to put up a hundred percent cash as collateral or there have to be certain collateralization of those mortgages.

So I question where credit unions—and most of the credit unions in Ohio said that they are not up against these limits. There are only a few. There are some. And so the question really comes down to, do the credit unions—this doesn't seem to be a capacity problem for all of them. It seems to be a capacity problem for just a few; is that correct?

Ms. MATZ. Yes, that is correct. But the cap has been a limiting figure for all credit unions that make business loans, because they are mindful of the cap. So they, as I said before, in some cases, if a staff person leaves, they won't fill the position or they won't really market, they will just deal with repeat customers because they are mindful of the cap. They don't want to get close to the cap and then have to turn away business.

Mr. RENACCI. Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you. And I would like to recognize Mr. Hinojosa for 5 minutes for questions.

Mr. HINOJOSA. Chairwoman Matz, Congress created the Corporate Credit Union Stabilization Fund you proposed. It allows credit unions to spread the entire cost of replenishing the losses experienced by the conservatorship of the corporate credit unions over a 7-year period. Had Congress not created the Corporate Credit Union Stabilization Fund, credit unions would have been forced by law to recapitalize the losses from the recent crisis in 1 year, thereby endangering many credit unions and their membership. It is my understanding, as I noted in my opening remarks, that a number of those credit unions remain undercapitalized.

As of this year, June 2011, I believe you placed 381 credit unions on your watch list, and 5 corporate credit unions have been put in conservatorship. I also noted certain data indicates that 6,900 of those community banks are adequately capitalized and could make, but they are not making commercial loans for some reason. If community banks are unable or unwilling to make those loans at this time, why should we believe that the credit unions can make up the difference?

Ms. MATZ. Credit unions have been increasing their business loans. As I said before in my testimony, since 2006, business lending in credit union—

Mr. HINOJOSA. I cannot hear you. Can you speak a little louder?

Ms. MATZ. Business lending in credit unions has increased 44 percent since 2006. So they have been increasing their business lending.

Mr. HINOJOSA. Why should Congress alter the member business lending cap it imposed on the credit unions back 15 years ago?

Ms. MATZ. I'm sorry, I didn't—

Mr. HINOJOSA. Why should Congress alter the lending cap it imposed on the credit unions in 1998?

Ms. MATZ. It will provide more opportunity for credit unions to make business loans, which serves an important need in their community. These are loans that are very small. The average is $222,000. They are made to small businesses that are members of the credit union. So they fill an important need in the community. But as a regulator, I think it is important because it helps to diversify their portfolios. And I think that it provides an extra measure of soundness, of diversity to their portfolio, which is another safety and soundness measure.

Mr. HINOJOSA. How do you feel about Congress taking and reforming the Act that allows the credit unions to make loans and consider changing the tax exemption that you have, or that they have, and letting you all pay taxes?

Ms. MATZ. Tax exemption is an important issue, but it is really a decision that Congress has to make. As a potential regulator, I just focus on safety and soundness. And if credit unions were taxed, it would have a very serious adverse impact on their safety and soundness, because the only way credit unions can raise capital is through retained earnings. They can't sell stock. They can only have retained earnings from within their membership. If they were limited to their retained earnings and they were taxed, their net worth would be reduced significantly. So it would have a very serious impact on their safety and soundness.

Mr. HINOJOSA. I yield back.

Chairwoman CAPITO. The gentleman yields back. I would like to recognize Mr. Royce for 5 minutes for questions.

Mr. ROYCE. Thank you.

Chairwoman Matz, would you pull the microphone close to you there, just pull it up close. Okay.

One of the things you say in your testimony is that 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. You say that most credit union member business lending is not simply taking the place of small business lending that banks would have done anyway. In other words, if that dynamic is going on, is that because many of these loans are smaller loans?

Ms. MATZ. Yes, that is my understanding.

Mr. ROYCE. That is what drives it, and that in turn, your argument is that this drives access to credit in a way that otherwise wouldn't occur?

Ms. MATZ. That is correct.

Mr. ROYCE. Without—maybe explain for a little bit the problem that the credit unions under the $45 million in assets have when making member business lending loans, given that such programs have a certain economy of scale, right?

Ms. MATZ. Yes.

Mr. ROYCE. And so you are up against the 12.25 percent cap. Two-thirds of credit unions are under this $45 million in assets. For those above, they have generally had the member business lending programs, but the cap then is a factor in them making the decision in terms of member business lending, right?

Ms. MATZ. That is right.

Mr. ROYCE. Because of the economies of scale?

Ms. MATZ. That is correct.

Mr. ROYCE. Let me ask you another question. As the regulator tasked with ensuring credit unions remain safe and sound, do you believe credit unions have the experience and expertise for this type of member business lending?

Ms. MATZ. Definitely, yes, and I think that their track record indicates that. Their delinquencies are competitive. Their charge-offs are not very high. Between 2009 and 2010, 55 credit unions failed, and only one of those failures was related to business lending. So I think they have a very good track record.

Mr. ROYCE. Let me ask you another question. Are you concerned that raising the cap would open the credit unions up to additional risk?

Ms. MATZ. No, I am not. I think that the tiered approach provides an excellent way for credit unions to increase their lending in a very safe and sound way. We would be supervising it very carefully, and they would have to meet some very significant thresholds in order to get beyond the 12.25 percent.

Mr. ROYCE. And the methodology here is also this isn't a blanket increase for all credit unions; there is a series of criteria that would have to be met in order to qualify—they would have to show they had this expertise. As I understand the way it would work, they would have to get the approval—

Ms. MATZ. That is correct.

Mr. ROYCE. —in order to move forward? Let me ask you another question. We have alternative programs out there, but one of them was the $30 billion Small Business Lending Fund. Now, for those of us here, we know how that was supposed to work, but the Wall Street Journal just ran a piece last October 6th that says that more than half of the money that has gone out has come back to the Treasury so that those institutions can get out from under the TARP restrictions and higher rates. One of the participants even called this a shell game.

The advantage with respect to the approach we are doing here is that we are not taking Federal—we are not going out and borrowing additional Federal funds to do it. We are trying to take a focused area of expertise that certain credit unions have on small business lending and expand that cap in a way that for the segment of the market where what, three-quarters—I am going through the study by the Fed—three-quarters of small businesses are saying they don't have access, they were turned down in terms of the credit that they were seeking in 2010, or they received only some of the financing that they requested. Would this help meet that demand?

Ms. MATZ. Very much so. Our chief economist has estimated that the passage of the legislation that you have introduced would add $5 billion in new lending.

Mr. ROYCE. And that is a lot of jobs that would go with that $5 billion?

Ms. MATZ. A lot of jobs.

Mr. ROYCE. Madam Chairwoman, my time has expired. Thank you, Chairwoman Matz.

Chairwoman CAPITO. The gentleman's time has expired. I want to recognize Mrs. McCarthy for 5 minutes for questions.

Mrs. MCCARTHY OF NEW YORK. Thank you, Madam Chairwoman.

I know we have all asked you to speak a little bit louder. You have a very soft voice so all of us up here are really struggling to hear your answers. So if you could speak right into the microphone, it would help not only us, but everybody behind you, to hear you.

If you could really discuss a little bit deeper the adjustments in regulations and oversight from when the NCUA first adopted rules and regulations regarding member business lending prior to the lending cap, up to currently with the lending cap in place.

Ms. MATZ. The rules that we have put in place?

Mrs. MCCARTHY OF NEW YORK. Yes.

Ms. MATZ. We have had numerous iterations over the years in the regulations overseeing business lending, we have limits on how many loans can be made to one borrower, on the experience level of the business lenders on how much collateral is required, and on personal guarantees. So we have put in place a number of regulations to make sure that business lending is done in a safe and sound way, that it is underwritten well and well-collateralized.

Mrs. MCCARTHY OF NEW YORK. So if this legislation moves forward, what kind of legislation do you see coming down—or how do you basically look to put regulations out there for safety and soundness to make sure that this is being carried through in the intent of what the bill is looking for?

Ms. MATZ. I could see NCUA coming through with regulations dealing with the 30 percent annual increase, so that credit unions that made the cut to the second tier couldn't automatically go up to 30 percent increase in their business lending. There would be additional thresholds for them and additional qualifications that they would have to have in order to get there. We probably would also increase even further the experience required of their senior commercial business lender.

Mrs. MCCARTHY OF NEW YORK. Just to kind of follow through on that. With the developments that have occurred within the member business lending, which calls for enhanced migration of risk, should the member businesses' lending cap be raised; how will NCUA ensure proper risk management; and what criteria would be used to approve a credit union for additional member business lending authority?

Ms. MATZ. The criteria put into the legislation would be a very good start, that a credit union would have to have made business loans for 5 years. They would have to be well-capitalized, which means they would have to have at least 7 percent capital. They would have to be at 80 percent or more of their cap for a year, and they would have to demonstrate that they have sound management and sound underwriting experience. So those are very significant hurdles for a credit union to overcome in order to get into the second tier.

Mrs. MCCARTHY OF NEW YORK. Thank you. I yield back my time.

Chairwoman CAPITO. The gentlelady yields back. Mr. Luetkemeyer for 5 minutes for questions.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Chairwoman Matz, do you know what a participating loan is?

Ms. MATZ. Pardon?

Mr. LUETKEMEYER. Do you know what a participating loan is?

Ms. MATZ. I do.

Mr. LUETKEMEYER. That is where you sell off part of the loan because you either can't make it, it is too big or—

Ms. MATZ. That is correct.

Mr. LUETKEMEYER. Do credit unions participate?

Ms. MATZ. Yes, they do.

Mr. LUETKEMEYER. How long do participation loans—or do you know, what part of the loans or percentage of the loans that these credit unions are making right now that are at the cap, do you know what percentage they participate at?

Ms. MATZ. I don't know the answer to that. I can get that for you.

Mr. LUETKEMEYER. I would appreciate that, if you would. That is something that perhaps many of the Members may not realize is another alternative. Instead of raising the cap, existing credit unions could participate out with other members, other credit unions in the area, or with even banks or whoever they want to, they could participate out the balance of the loan, and everybody would share. You could even sell it, without recourse, where there would be no undue liability back from the loan itself; is that not correct?

Ms. MATZ. They could, but they probably wouldn't be inclined to do that with the small loans. If you have a small loan for $220,000, you probably wouldn't be inclined to participate that out.

Mr. LUETKEMEYER. If you have a neighboring credit union that really doesn't make a lot of business loans, doesn't have the expertise to do that, yet you have the ability to do that and you have a good customer that you don't want to lose, you wouldn't make the loan and participate out part of it to a neighboring credit union, they wouldn't take it?

Ms. MATZ. No, they wouldn't be able to. If they don't have the expertise, they are not allowed to make or participate in business lending.

Mr. LUETKEMEYER. So they can't participate?

Ms. MATZ. That particular credit union could not.

Mr. LUETKEMEYER. Interesting. Okay. One of the other things about this business lending model that you have is that loans under $50,000, SBA-guaranteed, are not included in your business lending statistic; is that correct?

Ms. MATZ. That is correct.

Mr. LUETKEMEYER. So therefore, it would seem that the necessity of this bill today to raise the cap is for larger loans; would that be the way to infer that?

Ms. MATZ. Larger than $50,000. The average is $222,000, which is still a very small loan.

Mr. LUETKEMEYER. Okay. The larger the loan, the more the risk, is where I am going.

Ms. MATZ. That is correct.

Mr. LUETKEMEYER. The larger the loan, the more the risk, the more you have to lose, and the more careful you have to be in making that loan.

Ms. MATZ. Definitely.

Mr. LUETKEMEYER. So it looks to me like we are making the cap bigger so we can make bigger loans and take on more risk.

Ms. MATZ. No, not necessarily. Credit unions tend to make small loans. So they can make more small loans, not make fewer—

Mr. LUETKEMEYER. But they can also make bigger loans—

Ms. MATZ. They could make bigger loans.

Mr. LUETKEMEYER. That is the point I am getting to. Okay. You also made the comment a minute ago that you were asking some of your credit unions to diversify.

Ms. MATZ. Yes.

Mr. LUETKEMEYER. And asked them to make some business loans. Do you ask a bank to loan when they may not know how to service these loans?

Ms. MATZ. No, I don't ask them to make loans. I suggest that they consider getting into the member business lending to diversify their portfolio. It would only be if they have the proper experience on their staff and make the investments and have to get approval to make business loans.

Mr. LUETKEMEYER. Don't you think that is a little risky to ask them to jump into something they don't know anything about?

Ms. MATZ. I am not asking them to do it. I am suggesting it as an option for them.

Mr. LUETKEMEYER. Okay. You indicated a while ago, also with regard to interest rate risk—let me go on to something else here quickly before I run out of time.

You also made a comment about the amount of money for loans that you have to loan out. I am kind of curious, where does the money come from for the credit unions? Does it come strictly from deposits that are made in the credit union, or do the larger credit unions go out into the marketplace and take loans out or go into the marketplace and take up some securities, or they get money from other places?

Ms. MATZ. It is money from their members.

Mr. LUETKEMEYER. Only money from their members? They don't go out to anyplace else in the marketplace to get any kind of funds?

Ms. MATZ. No.

Mr. LUETKEMEYER. And I am also kind of curious; you made the comment a while ago with regards to I think Mr. Hinojosa's question on why you couldn't be taxed and then be able to survive. And I thought it was kind of interesting because you act like the only way you can pay your taxes is take it out of your existing earnings, and I think that—is that a fair statement?

Ms. MATZ. Yes.

Mr. LUETKEMEYER. If you are like a mutual insurance company, they are owned by their insurance holders, their policyholders; same thing as a credit union, by their members. Therefore, all you do is raise the price of your product to pay your taxes, and you still pay your dividends and get you enough retained earnings to be able to do all that; would that work?

Ms. MATZ. You are correct. Yes, they could raise their fees.

Mr. LUETKEMEYER. Okay. Very good. With that, just one final comment. I appreciate you commenting a while ago with regards to the banks and credit unions working together. It is actually—in most communities, it actually works that way. It seems like when we get to the regulatory time here, we get in each other's faces. But I think we have a great working relationship with most of the credit unions and banks in our area. Hopefully, we can continue that.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you. Mr. Scott for 5 minutes.

Mr. SCOTT. Thank you. Chairwoman Matz, is that correct?

Ms. MATZ. Yes, it is.

Mr. SCOTT. I want to talk about the need, for a moment, for the legislation. Could you tell me how many small businesses have been denied a loan from a bank that was able to secure one instead from the credit union?

Ms. MATZ. I wish I could. We don't keep records on that. Anecdotally, I hear about it, but we don't have any data on it.

Mr. SCOTT. What sort of data do you have, then, to justify the demand for this legislation? It seems to me that it would be very, very helpful if we had that sort of information. I think that might be something going forward, and if we want to increase the cap, what are the justifiable means to do so? Where is the demand for that? It just seems to me that would be the most significant empirical evidence, to show that you have these people coming and they have been denied by the bank—they can't get the service from the banks, so that is why we need to do that. Is there anything that—any information you have that could give us that justification?

Ms. MATZ. What we know is that member business loans are increasing. Credit unions are making more business loans, and that there are credit unions that aren't making business loans or that are making fewer business loans than they might ordinarily make, because they do not want to approach the cap or they don't want to make the investment because of the cap.

Mr. SCOTT. Speaking of that, how many credit unions are close to the cap?

Ms. MATZ. There are just over 400 credit unions that are over 50 percent of the cap. So it is about one in five of credit unions that make business loans are over 50 percent of the cap.

Mr. SCOTT. So tell us, what is the sense of urgency for this legislation is that if we can—I am looking for some things here that we can really hang our hat on to show the need, the necessity for this, that will help small businesses.

Ms. MATZ. The urgency is that it is a great way to serve their communities. Small businesses create jobs. The small businesses and the communities are having a hard time getting capital elsewhere, and credit unions are meeting that need.

Mr. SCOTT. You said that having capital—that is what I am getting at. We are getting to the point that I am trying to get at. What do you base that on? Just—what they say to you in—

Ms. MATZ. The Fed study that Mr. Royce pointed out which indicated that three-quarters of the small businesses said they have trouble getting access to capital.

Mr. SCOTT. All right. Now, you also say that this will create jobs. How many jobs? Where does that information come from? How is that substantiated and how many jobs?

Ms. MATZ. Our chief economist has indicated that this legislation would add about $5 billion in new lending. I don't have the information on how many jobs that equates to, but it would put $5 billion into the hands of small businesses.

Mr. SCOTT. There are roughly I think 16 percent of existing credit unions right now who are exempt from making these loans; is that correct?

Ms. MATZ. Yes.

Mr. SCOTT. Why is that?

Ms. MATZ. They are exempt either because they have the designation of a low-income credit union, and low-income credit unions are exempt from the cap because they were chartered for the purpose of making business loans, or because they historically have made business loans, and they were grandfathered in in 1998 when the cap was put into place.

Mr. SCOTT. And given—what would be your assessment if this—for the future of credit unions, if this bill is not passed? How detrimental would this be to your—

Ms. MATZ. It would really limit their ability to enter a new and important market. It would curb their ability to enter that market, which I feel is an important market for them. As I said, from a safety and soundness point of view in terms of diversifying their portfolio and moving away from some of the interest rate risk, it is very important.

Mr. SCOTT. All right. Thank you very much.

Chairwoman CAPITO. Thank you. Mr. Huizenga for 5 minutes for questions.

Mr. HUIZENGA. Thank you, Madam Chairwoman. I appreciate the opportunity and I thank you.

I have been here—how long exactly have we been here, a little over an hour, and I have been listening to the questions and the answers, and I am still not sure—and I want to give you an opportunity—maybe I am just not hearing it, except I feel like I have kind of heard both sides of this issue, and the direct question I have is: Is there or is there not a need in the increase for the cap from your perspective?

Ms. MATZ. There is.

Mr. HUIZENGA. You believe there is. Okay. So despite the very small number of credit unions that are either at their limit or near their limit, you believe that there is a distinct need for this to happen to make sure that there is sufficient credit out and available?

Ms. MATZ. There is, because I believe it is inhibiting all credit unions, not just those that are at or near the cap. It is inhibiting those that are significantly below the cap because they are afraid of getting close to the cap, and it is inhibiting credit unions that aren't making business loans at all because they are concerned about making the investment and not having the economies of scale to make that investment back.

Mr. HUIZENGA. Okay. Right. That is fair enough.

The other element that I am kind of curious about is why do you think, if there is such a fairly small number of entities or credit unions that are accessing this and there doesn't appear to be such significant competition out there, why do you think that there are people who are afraid of raising this cap? In a way, I sort of feel like my kids are coming and telling me, hey, we are going to stay up and we are going to catch Santa. And my answer to them is, knock yourself out, go ahead, stay up as late as you want, kids, because I know at 10:30, they are falling asleep. It doesn't matter, and in a way, if there is no need or lack of demand for this, then what is the harm in authorizing an increase in this loan cap. So I am just curious if you can address that a little bit.

Ms. MATZ. I don't see any harm in increasing the cap. I advocate for it. I think it is important. I think it will not detract from safety and soundness. I think it will increase the safety and soundness, and as a regulator I say that. But in addition, it will provide capital to small businesses and create jobs, but as a regulator, I am concerned about the safety and soundness.

Mr. HUIZENGA. And you believe that that can be addressed—

Ms. MATZ. I do.

Mr. HUIZENGA. —the safety and soundness element?

Ms. MATZ. Yes, I do.

Mr. HUIZENGA. So even despite the fact that there does not seem to be significant demand for this, at least as far as the numbers, you think it is significant enough?

Ms. MATZ. I think the number is kind of invisible, because you look at the numbers that are near the cap, but that doesn't tell you all the credit unions that are holding back or not doing it because they are put off by the cap.

Mr. HUIZENGA. So just to play devil's advocate on this, even despite the advantages that have been granted legislatively, some of the things that have been talked about here, the tax-exempt status and those kinds of things, and it is a different playing field—I am not going to make a judgment as to whether it was even or equal or whether all those other things, that there is a reason for the chartering the way that it was in the legislation—you still believe this, that this is something that is important to do?

Ms. MATZ. Yes, I do.

Mr. HUIZENGA. Okay. I appreciate that. Thank you, Madam Chairwoman. I yield back.

Chairwoman CAPITO. Thank you. Mr. Meeks for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman, and thank you, Chairwoman Matz.

Let me just follow up on that. If the caps were to be raised, what would you anticipate the difference being? What would you anticipate the functioning of the various credit unions? What would they do differently than they are doing now with the caps raised? What do you see? Let me just ask you that question before I give you the answer to it.

Ms. MATZ. More credit unions would make more loans. They wouldn't hold back. They wouldn't be afraid of approaching the cap. So, as I said, if you have a credit union that is $100 million and can make $12 million in loans and they are already at $6 million, so she is at 50 percent and she is telling me that she is slowing down, she doesn't want to get to the cap, if that cap were raised, she is telling me she could just keep making loans. And so even those that aren't even very close to the cap are are feeling that they cannot keep making loans, and then there are those who have chosen not to make business loans at all because they don't want to make the investment.

Mr. MEEKS. So as Mr. Scott was trying to find out, he was trying to get specific data. Are you telling us that it has been the general feeling that there have been a number of credit unions that have articulated to you that they would do substantially more and couldn't, because they fear the demand from individuals who are coming into their credit unions for these loans and they wish they could give them to them, but they don't because it doesn't fit their own business model because of the cap; is that correct?

Ms. MATZ. That is correct.

Mr. MEEKS. And so I think that what we are also—let me just ask this question before I go there. You said that there were three categories of individuals, about 60 percent that are exempt from the cap. One was low-income communities, if the credit union was in a low-income community; is that correct?

Ms. MATZ. It is a credit union whose members are 51 percent low income.

Mr. MEEKS. Okay. And of those members, then that credit union can offer business loans? Because I know some can and some can't,

Ms. MATZ. They can, yes.

Mr. MEEKS. They can? And you also indicated earlier in your testimony that there were some credit unions, because they did not have the experience nor had they ever done it before, they could not offer business loans; is that correct?

Ms. MATZ. That is correct.

Mr. MEEKS. If there is someone now who cannot offer business loans currently, what would they have to do if, in fact, in the future they wanted to offer business loans? What would be their requirements to go from one level to the other?

Ms. MATZ. They would have to hire an experienced business lender, and they would have to have a business plan and policies for how they would make their business loans, how they would underwrite them, how they would collateralize them, and it would have to be approved by NCUA.

Mr. MEEKS. Wearing your hat as a regulator then, would be how you would make sure that there is not additional risk going out there in regards to the loans that are being given by the credit unions; is that right?

Ms. MATZ. Yes.

Mr. MEEKS. We know that, for example—well, let me ask this question first, because I didn't understand the whole definition of net growth, because I have had some credit unions come to me who are fairly successful, and they have complimented you on saying that there should be some supplemental capital. But net growth, from what I understand, excludes supplemental capital and, therefore, could possibly punish healthier credit unions for attracting new deposits because that is not—can you tell me about that definition and how can we discuss the need for supplemental capital further, and what is NCUA's plan for seeking legislation necessary to provide that kind of relief?

Ms. MATZ. You are entirely right. The definition of net worth is retained earnings divided by assets. So the more deposits credit unions get, the larger the denominator gets, and that pulls down the net worth. So, even though it seems counterintuitive, when members have confidence in the credit union and they put their deposits in the credit union, it can pull down their net worth. So that is why there are many credit unions that feel that they need to have access to supplemental capital. And I agree with that if they are a healthy credit union and that the supplemental capital would be so that they do not have to discourage deposits.

Mr. MEEKS. So my question to you: Do you think that something should be done with that definition regulatorily, or is it good to keep it the way it is because it has more soundness? What are your thoughts on that?

Ms. MATZ. I think it should be modified.

Mr. MEEKS. Thank you. I agree with you.

Chairwoman CAPITO. The gentleman's time has expired. Mr. Grimm for 5 minutes.

Mr. GRIMM. Thank you, Madam Chairwoman. I appreciate and thank you, Madam Chairwoman.

I do have to disagree with my colleague, Mr. Huizenga. I think you put the rugrats to bed early because Santa Claus gets tired and wants time to eat the cookies and stuff like that. Santa Claus is getting older and older, as you know.

But I think Santa Claus is a member of a credit union. There has to be a credit union for all of those bunny rabbits, all those things that are around.

Ms. MATZ. I am sure there is a field of membership for Santa Clauses.

Mr. GRIMM. A lot of my questions have been answered already. Just to—there is one thing that seems to disconnect, not whether it is good or bad. Just we do hear—and I just came from another hearing in Oversight with community banks that demand is down overall, and that seems to gibe with what I am hearing from a lot of the small business owners that I speak to who simply say, I can't risk expanding my business right now because I have no idea what is going to happen as a result of the new health care law. I can't predict what our tax rates are going to be tomorrow, because there is constantly this banter between raising them and lowering them.

So the overall uncertainty is leading, I think, to the many small businesses holding what they have and corporations sitting on cash and waiting for some of this uncertainty to dissipate.

Why do you think—and to some extent, I am asking you to speculate, and this isn't a court of law, so I can ask you to do that. Why is it different for the credit unions to see—I think it has gone up 44 percent since 2007?

Ms. MATZ. Six.

Mr. GRIMM. Since 2006.

Ms. MATZ. Since 2007, that is correct.

Mr. GRIMM. I am good with numbers, memorizing them. So why do you think that it seems to be different than what I am hearing from the small businesses and from the local banks for credit unions? It is an anomaly, if you will.

Ms. MATZ. I can only speculate. Credit unions tend to have a good relationship with their members, and so if the member needs a loan, particularly a small loan, they will go to the credit union for it. I don't have an answer for it, but that is just my guess.

Mr. GRIMM. Is it plausible that to a small extent, some of the issues I have been hearing from the local banks, community banks, is that the regulators have been particularly onerous, and as they clamp down and really look to second-guess almost every loan they do, they are denying anything that is even remotely questionable, and loans that probably should be approved are not being approved and maybe that is some of the overflow business that you are seeing—is that just a possibility?

Ms. MATZ. I can't comment on my colleagues at the FDIC. I hear the same thing from credit unions, also. I think there is always a natural tension between regulators and those that they regulate.

But I really, I don't know why the situation is like it is with the banks.

Mr. GRIMM. And one last question. I understand why someone would be reluctant to spend a lot of capital if they think that they are going to reach their limit and they won't—it is scalable and I understand that. But what happens when they reach their limit? Are they looked at differently? What is the reality? Can you just explain to the committee the reality of hitting your limit? We keep talking about hitting the limit. Could you just articulate what that means in real life for a credit union?

Ms. MATZ. It means that they can no longer make business loans when they hit that limit, and even at 80 percent, they are telling me they are turning new members away because they want to use that capacity for existing members who have business loans who need more or larger loans to expand.

Mr. GRIMM. Okay. So if I can just make sure that I understand it. You want to be able to make sure that you are servicing your current members, and if you get close to that limit, extending credit to new members, there may be an existing member that you have done a tremendous amount of business with who needs to go back to the well, so to speak, and now you don't have that liquidity, that access for them, and now you're denying members, which is just not good business for any business; am I correct?

Ms. MATZ. Correct.

Mr. GRIMM. Thank you so very much. I appreciate it.

Chairwoman CAPITO. Thank you. Mr. Carney for 5 minutes.

Mr. CARNEY. Thank you, Madam Chairwoman, and thank you, Chairwoman Matz, for coming in today and helping us with this. I have been listening to this for over an hour now, and I am a little bit confused. Some of the questions that I ask I am sure will be redundant or repetitive for others. I am trying to understand the logic of all this.

Before 1987, there weren't regulations on credit unions as it related to these types of loans. I am just reading from background materials.

Ms. MATZ. Yes, there were no regulations; that is correct.

Mr. CARNEY. Right. So then there were regulations put in place because there were failures, my background material indicates, caused by risky loans on businesses; is that correct? Are you familiar with the pre-1987 experience?

Ms. MATZ. I am not all that familiar with it, but what I am surmising is that the NCUA saw that credit unions were starting to make business loans and there were no regulations. So in order to make sure that they were being done in a safe and sound manner, regulations were implemented.

Mr. CARNEY. So NCUA developed those regulations and set limitations, presumably?

Ms. MATZ. Yes.

Mr. CARNEY. Those regulations, according to this background material, were put into law in 1998. Is that when the cap—

Ms. MATZ. The cap was put into law in 1998.

Mr. CARNEY. Okay.

Ms. MATZ. Yes.

Mr. CARNEY. And so is the logic there that the cap—the purpose of the cap was to prevent the risky business loans that caused the problem prior to 1987?

Ms. MATZ. I don't know why the cap was put in place.

Mr. CARNEY. Because your testimony basically is that business lending is, frankly, good for the safety and soundness of the credit unions; is that correct?

Ms. MATZ. Yes. I don't know why the cap was put in place, but I don't believe it was done for safety and soundness reasons.

Mr. CARNEY. And so today, we have this cap. It doesn't appear—there are kind of two ways you can look at the cap. One is that credit unions are bumping up against the cap and want to lend more. That doesn't seem to be the case, although you indicate that business decisions have to be made as to whether to make investments to do appropriate lending above that. But it doesn't appear that enough credit unions are at that point yet; is that fair?

Ms. MATZ. All credit unions that are interested in doing member business lending are affected by the cap, regardless of where they are in relation to the cap.

Mr. CARNEY. But your own view is that the cap really is unnecessary; in fact, it hurts safety and soundness; and in fact, we have low-income credit unions which operate in areas where with people—or I guess members with their—50 percent of which are below a certain income level that don't have any cap?

Ms. MATZ. That is correct.

Mr. CARNEY. Does that make any sense? From that perspective, is income some kind of determinant of whether those loans are paid back or not?

Ms. MATZ. I don't think it is in relation to it. It is really their credit history, not necessarily their income. Low-income borrowers can be perfectly good credit risks.

Mr. CARNEY. So is it your view that there shouldn't be any cap at all?

Ms. MATZ. That would be my preference, but I certainly support the legislation as it is written, with a doubling of the cap.

Mr. CARNEY. And that goes to probably my last question, which is, where did the—maybe I should ask one of the sponsors—27.5 percent cap come from and what is magical about 27.5 percent? How do we get—maybe I should ask, how did we get 12.25 percent in the first instance?

Ms. MATZ. I don't know how we got the 12.25 percent, but I am told that the 27.5 percent came from negotiating for Treasury support of the legislation, and they wanted to have the 27.5 percent.

Mr. CARNEY. So it looks like I have time for one more question. There have been a lot of questions asked of you of the need—small businesses needing this. And I am wondering if this is competitive space with small community banks, or is it space where the credit unions fit a particular niche, in your view?

Ms. MATZ. I do hear from credit unions that they are making loans that banks in their community did not or would not make. But there is also the Small Business study which was released a couple of weeks ago, which indicated that for every dollar in loans credit union make, 81 cents is new money. So there might be some competition with banks, but it seems like it is very limited.

Mr. CARNEY. Thank you. My time has expired.

Chairwoman CAPITO. Thank you. I believe Mr. Manzullo has no questions, that is correct. So, Madam Chairwoman, we will dismiss you. Thank you for your testimony and your answers to our questions. The first panel is dismissed.

I would now like to call up the second panel of witnesses. I will introduce them individually once they get set up. In the meantime, I would like to ask unanimous consent to insert the following statements into the record: the Credit Union Supplemental Capital Coalition; the National Association of REALTORS®; and the Consumer Bankers Association. Without objection, it is so ordered.

I want to thank you all. That was a pretty quick transition there. So I am going to introduce everybody individually for the purposes of making a 5-minute opening statement.

Our first witness on the second panel is Mr. Sal Marranca, director, president, and chief executive officer, Cattaraugus County Bank, on behalf of the Independent Community Bankers of America. If you could pull the microphone close, everybody, when you give your testimony. Welcome, and you are recognized for 5 minutes for an opening statement.

STATEMENT OF SALVATORE MARRANCA, DIRECTOR, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, CATTARAUGUS COUNTY BANK; AND CHAIRMAN, INDEPENDENT COMMUNITY BANKERS OF AMERICA, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Mr. MARRANCA. Thank you, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. I am Sal Marranca, director, president, and CEO of Cattaraugus County Bank. I am also chairman of the Independent Community Bankers of America.

Cattaraugus County Bank, a 110-year-old bank, is a State-chartered community bank with $180 million in assets located in Little Valley, New York. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing to testify on legislation that would expand credit union powers by raising the cap on member business loans.

We strongly oppose the Small Business Lending Enhancement Act, H.R. 1418. Congress should not expand credit union business lending powers unless it also is prepared to tax credit unions and require compliance with the Community Reinvestment Act. The tax exemption is directly linked to their original mission of serving individuals of modest means. After decades of "mission creep," resulting in multibillion-dollar credit unions, the tax exemption can no longer be justified.

Credit union business lending is an immediate threat to my bank. I am not afraid to compete with other taxpaying lenders, even larger banks, but the credit union exemption creates an unfair advantage and distorts the market. I have lost business lending opportunities with established customers to credit unions who underpriced my competitive rates.

H.R. 1418 would allow the NCUA to approve member business loans up to 27.5 percent of the credit union's assets, more than double the current cap of 12.25 percent. The cap was not set arbitrarily, but was intended to ensure that commercial lending would be no more than a marginal part of a credit union's lending.

The credit unions have portrayed H.R. 1418 as an effort to make more credit available for small businesses and create jobs. This is simply not the case. Demand for credit is very weak in the current credit environment. My bank and thousands of community banks stand ready to assist our small business customers as demand for credit returns.

It is also true that only a small number of credit unions are at or near the current member business lending cap, just over 2 percent of the approximately 7,300 credit unions according to the NCUA. Over 70 percent of credit unions report no member business loans at all.

Those credit unions that are at or near the cap are the largest and most complex credit unions, and the business loans they make are often multimillion-dollar deals, not small business loans. There is ample capacity for the remaining 98 percent of credit unions to expand their member business lending. What is more, there are numerous exemptions to the member business lending cap, including any loan of less than $50,000, SBA loans of up to $5 million, and nonmember loans and loan participations purchased from another credit union.

Some advocates of H.R. 1418 claim that expanded credit union commercial lending would come at no cost to taxpayers. The Joint Committee on Taxation, OMB, and CBO have all identified credit lending as a tax subsidy. That is why the bipartisan Policy Center's Debt Reduction Task Force recommended eliminating the tax exemption. We urge the Joint Select Committee on Deficit Reduction to consider that as well.

What is the cost of the subsidy? The most comprehensive analysis to date was done by the nonpartisan Tax Foundation which valued the subsidy at $32 billion over a 10-year budget window. The credit union tax exemption also deprives State and local governments of revenue, many of which are facing deep cuts to essential services to remain solvent. Repeal of the credit union exemption is warranted, not only for the sake of deficit reduction, but as a matter of tax equity. If credit unions expand their business lending powers and become the equivalent of banks, tax exemption can no longer be justified.

Thank you again for convening this important hearing. As a community banker, I feel the direct impact of credit union commercial lending. ICBA strongly urges the committee to reject calls for new powers and tax-subsidized credit unions that will not, despite assertions to the contrary, expand small business credit or create jobs.

I look forward to answering your questions. Thank you.

[The prepared statement of Mr. Marranca can be found on page 88 of the appendix.]

Chairwoman CAPITO. Thank you.

Our next witness is Mr. Albert C. Kelly, Jr., president and chief executive officer, SpiritBank; and chairman-elect, American Bankers Association. Welcome.

STATEMENT OF ALBERT C. KELLY, JR., PRESIDENT AND CHIEF EXECUTIVE OFFICER, SPIRITBANK; AND CHAIRMAN-ELECT, AMERICAN BANKERS ASSOCIATION, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION (ABA)

Mr. KELLY. Thank you, Chairwoman Capito, and Ranking Member Maloney. My name is Albert Kelly. I am president and CEO of SpiritBank in Bristow, Oklahoma, and chairman-elect of the American Bankers Association. Thank you for the opportunity to testify today.

ABA is strongly opposed to recent efforts by the credit union industry to expand the business lending authority of credit unions. This effort, most recently embodied in H.R. 1418, would allow qualified credit unions that are within 80 percent of their member business lending cap to significantly increase their business lending at the expense of making consumer loans. This increase in business lending would shift some business loans to tax-exempt credit unions from tax-paying banks, causing an increase to the Federal deficit just when Congress is looking for ways to reduce the government debt.

Under current law, credit unions have an aggregate member business lending cap of 12.25 percent of assets. Business loans under $50,000 do not even count against this cap, nor do many other types of business loans. These exemptions mean that credit unions already have an unlimited ability to fund small business loans without the need to seek increases in their member lending limits.

This proposed increase is only directed at larger loans and would benefit only a few large, aggressive credit unions which are already effectively tax-exempt banks. Just 96 credit unions out of 7,292 are within 80 percent of their congressionally mandated cap. This is just over 1 percent of the entire credit union industry.

There are good reasons for a limit on credit union business lending. Business lending is riskier than consumer lending, and thus poses a safety and soundness risk to the Credit Union Insurance Fund. In fact, business lending was found to be a major contributor to failure in 7 of the 10 costliest credit union failures. Also, the credit union tax exemption was created to serve people of modest means, possessing a common bond.

Instead of raising the member business loan cap, there is another alternative. Credit unions that want to engage in expanded business lending can switch to a mutual savings bank charter. This charter provides the flexibility credit unions desire and preserves the multimember focus that is the trademark of a credit union charter. In fact, the members of HAR-CO Federal Credit Union recently approved switching to a mutual savings bank charter. Another credit union, Technology Credit Union, has just begun that process.

The decision to become a mutual savings bank is based upon the opportunities provided by this charter. Unfortunately, the NCUA has erected obstacles, making it extremely difficult for a credit union to exercise its choice to become a mutual savings bank. Some credit union trade associations actively oppose credit union conversions. Removal of the NCUA's opposition to conversion would be a far better alternative to enable more business lending, and since mutual savings banks pay taxes, conversions would help to reduce the Federal deficit.

Make no mistake about it, H.R. 1418 would allow a credit union to look and act just like a bank, without the obligation to pay taxes or have bank-like regulatory requirements such as the Community Reinvestment Act or examinations by the FDIC.

I understand that the argument for this expansion is based on making loans that create jobs. I have had the opportunity to talk with bankers all over the United States, and I can tell you that in my community and around the country, banks are making all the loans that can be made. Additional lending by tax-exempt credit unions will either take loans away from tax-paying banks or will add risk that will translate into failed loans and failed institutions, not increased employment.

The correct path to increase business lending is not expanded flexibility for credit unions but conversion to a mutual bank charter.

Thank you for the opportunity to share ABA's thoughts on credit union member business lending. I am happy to answer any questions.

[The prepared statement of Mr. Kelly can be found on page 77 of the appendix.]

Chairwoman CAPITO. Thank you.

Our third witness is Mr. Gary Grinnell, president and chief executive officer, Corning Credit Union, on behalf of the National Association of Federal Credit Unions. Welcome.

STATEMENT OF GARY GRINNELL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CORNING FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS (NAFCU)

Mr. GRINNELL. Good afternoon, Chairwoman Capito, Ranking Member Maloney, and members of the subcommittee. My name is Gary Grinnell. I am testifying today on behalf of NAFCU.

I appreciate the opportunity to share my views with the committee on H.R. 1418 and credit union member business lending. We hope you will agree that raising the artificial and outdated cap on member business lending is overdue and a necessary pro-growth step that will help small businesses and communities recover from the current economic crisis.

H.R. 1418 is about jobs: saving jobs; and creating jobs. Who could be opposed to that? It is important to note that credit unions have a nominal market share of the small business lending universe, approximately 5 percent; clearly, not a threat to the domination of banks in this market. A 2011 SBA study indicates that credit union business lending increased during the recent financial crisis while banks decreased. This is evidence that credit unions continued to meet the capital needs of their business members, even during the most difficult times.

Corning Credit Union currently exceeds 80 percent of its cap, and we forecast that we will reach the cap by mid-2012 if Congress does not act.

During the recent economic downturn, as banks stopped lending to their clients, Corning Credit Union has been able to fill an important role to provide these businesses with funding they need to continue to grow and create jobs. We even helped a bank employee when she couldn't get help from her own industry. This member is a commercial lender who works at a community bank. She also owns rental properties. After a bank informed her that they would not renew her commercial mortgage after the initial 5-year balloon period, she wasn't even able to obtain financing from her employer, let alone other banks in the area. She came to Corning Credit Union, and we were able to refinance her investment property loans.

Mayor Bill Saffo of Wilmington, North Carolina, turned to us after he received numerous calls at his office from small business owners desperate to obtain financing. The banks, both local and national, have aggressively moved to slash access to credit in this market. The mayor recognized that Corning Credit Union is one of the few financial institutions that buck this trend. I ask permission to insert a letter from Mayor Saffo in support of H.R. 1418 into the hearing record.

I have also brought with me a stack of letters from small businesses that we have helped with loans. These letters tell stories of how bankers have turned their backs on small businesses and how they appreciate the member-focused customer service that they get at Corning Credit Union. These letters are asking for your help in making sure that Corning Credit Union and others like us will be able to meet their business loan needs in the future. I ask that these letters also be inserted into the record.

Due to our strong balance sheet, we have almost $300 million available to lend, but our hands are tied because of the arbitrary cap. We should emphasize that these are not taxpayer dollars or government stimulus. It is cash from our depositors that can be used as a source of credit-productive purposes, such as helping small businesses in our communities.

In response to some of the criticisms of H.R. 1418, I think it is important that some key points are made. First, an examination of call report data indicates that credit unions with MBLs actually have lower business loan losses than banks.

Second, credit unions make the small loans many banks don't want to make. The average size of a credit union MBL is $222,000.

Third, the banking industry also argues that the credit union MBL cap should not be raised due to the credit union tax exemption. What the banking industry conveniently forgets to mention is that a large number of banks do not pay corporate Federal income tax because of their Subchapter S status and that the value of their tax break is estimated to be just over $2 billion for 2010, which is significantly greater than the estimated value of the annual credit union tax expenditure.

Lastly, some critics claim that only a limited percentage of credit unions are actually at the arbitrary member business lending cap, and therefore nothing needs to be done. This view fails to see the big picture of how the cap acts as a deterrent for efforts to increase business lending and create American jobs. Those credit unions that are not near the cap have a disincentive to invest in the business lending programs.

It is estimated that enacting H.R. 1418 could help spur over $13 billion in new lending and create over 140,000 new American jobs in the first year alone. NAFCU believes that this is a real bipartisan jobs package that everybody should support. As I said in my opening, H.R. 1418 is about jobs: saving jobs; and creating jobs. I ask you again: Who could be opposed to that?

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our Nation's economy. I would welcome any questions you may have.

[The prepared statement of Mr. Grinnell can be found on page 52 of the appendix.]

Chairwoman CAPITO. Thank you, Mr. Grinnell.

Our next witness is Mr. Jeff York, president and chief executive officer, Coasthills Federal Credit Union, on behalf of the Credit Union National Association. Welcome.

STATEMENT OF JEFF YORK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COASTHILLS FEDERAL CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Mr. YORK. Madam Chairwoman, thank you for holding today's hearing.

The recession has affected everyone. One in six households is currently affected by unemployment and underemployment. Despite recent economic difficulties, credit unions like mine have been there for our members. We have worked with them during the housing crisis and when they lost their jobs. Credit unions have been on the front lines of the recession, and we want to do more.

Many Americans are frustrated by programs that did not live up to their potential and disagreements that bring the government to the brink of shutdown. Small businesses are being hit hard. To add insult to injury, banks have pulled back access to credit. Americans need jobs. Small businesses want to help create jobs. To do that, they need a partner who will stand with them and help them succeed. Too many are not finding that partner at a bank. Credit unions are willing to help, but the statutory cap on credit union business lending makes this increasingly difficult.

I am here today to endorse a bipartisan solution for small business owners. Representatives Ed Royce and Carolyn McCarthy have introduced legislation that gives qualifying credit unions the ability to lend in excess of the current statutory business lending cap. This balanced approach permits credit unions to have an immediate impact on jobs without putting our share insurance fund in jeopardy.

This bill will free up approximately $13 billion in capital for small businesses, allowing them to create 140,000 jobs in the first year after implementation, all without a single dime of taxpayer money. Let me say that again: $13 billion for small businesses, 140,000 jobs, no taxpayer money. Who would be against this?

The banks will continue to spread misinformation about credit unions, our powers, and our structure to try to persuade you to not act on this bill. They will try to distract you with irrelevant and rare examples of troubled credit unions, knowing full well that the few credit unions that are not well-capitalized will not be eligible to engage in additional business lending under this legislation. They will blame the economy, examiners, and regulation for the failure to help small businesses when the government has all but begged them to help.

The banks say there are only a handful of credit unions affected by the cap. My credit union is almost certainly not on their list, but Madam Chairwoman, I assure you that we are affected by the cap. My credit union has been making business loans for members for many years. Our business loan growth has pushed us to over 50 percent of the cap. I have the demand now to reach my cap in 6 months if that made sense for my credit union, but I manage the cap because hitting that wall would force me to abruptly shut down my business lending program, lay off loan officers, and impede my ability to meet the continuing needs of my existing business members.

If Congress does not act, we will not be able to be there for some of the members that we have helped in the past like Slo Gas & Mart, who we helped with a loan in 2009 that created 15 jobs; like Waterwheel, a car wash facility that we helped in 2010 that created another 15 jobs; jobs here, and 15 jobs there may not sound like much, but when you consider the national potential, it very quickly adds up to 140,000 new jobs in the first year if the Royce-McCarthy bill is enacted.

There are almost 600 credit unions like mine affected by the cap. These mostly small credit unions account for 75 percent of all business loans subject to the cap, and these credit unions have been the primary contributors to the recent business loan growth. The very credit unions that continue to lend when the banks stop will themselves have to stop business lending over the next 2 or 3 years unless Congress acts.

Make no mistake: We have the experience, the liquidity, the demand, and the desire to invest in our members, but we are being stopped by the cap and by the banks who oppose raising it. Unlike the $30 billion for the community banks and the SBLF, not a single appropriated dollar will be needed to create jobs under the Royce-McCarthy bill. The impact of allowing experienced, well-capitalized, and well-managed credit unions to lend beyond the current statutory cap would be substantially greater than the ultimate impact of the SBLF.

My written testimony goes into further detail regarding this legislation which has been endorsed by the Treasury Department and NCUA. We appreciate 88 Members of the House, including the six members of this subcommittee, who cosponsored this bill, as well as the 20 Senators who have cosponsored the companion bill offered by Senators Udall, Snowe, and others.

Madam Chairwoman, we appreciate you holding this hearing. Congress, please don't leave these jobs on the table. Give small businesses a chance to create jobs, and allow credit unions like mine to be there for our members. We urge you to pass H.R. 1418.

Thank you.

[The prepared statement of Mr. York can be found on page 120 of the appendix.]

Chairwoman CAPITO. Thank you.

And our final witness is Mr. Mike Hanson, president and chief executive officer, Massachusetts Credit Union Share Insurance Corporation. Welcome.

STATEMENT OF MICHAEL C. HANSON, PRESIDENT AND CHIEF EXECUTIVE OFFICER, MASSACHUSETTS CREDIT UNION SHARE INSURANCE CORPORATION (MSIC)

Mr. HANSON. Thank you, Madam Chairwoman. Thank you for holding today's hearing.

My name is Mike Hanson, and I serve as president and CEO of MSIC, the Massachusetts Credit Union Share Insurance Corporation. We are the Nation's oldest insurer of credit union deposits. We were formed by an act of the Massachusetts legislature in 1961 to effect a public policy that all credit union members in Massachusetts be fully ensured. This year, MSIC celebrates its 50th anniversary, and we continue our history of providing safe and secure deposit insurance for Massachusetts consumers in good times and in bad.

Today, MSIC is an excess insurer, and we provide deposit insurance for amounts in excess of those insured by the NCUA. We insure 97 member credit unions operating in Massachusetts, and those institutions hold $18 billion in assets and serve approximately 1.6 million consumers.

MSIC also serves as the receiver for the Massachusetts Commissioner of Banks, and we provide technical capital management and training assistance to our member credit unions.

MSIC is a not-for-profit cooperative corporation. We run an insurance fund contributed to by our members over the years, and our fund backs the insurance, as well as it being backed by our 97 member credit unions. We are a true cooperative, and we are not sponsored or funded by any governmental activity.

In managing our insurance risk, we have a substantial monitoring program which evaluates both Massachusetts credit unions and the industry as a whole, and our independent evaluation of the condition of the credit union industry is the basis for my testimony today.

My own background, by way of introduction, has been submitted with my written testimony, but there is one relevant fact. In 1991 and 1992, I served as Massachusetts Commissioner of Banks during the height of the New England banking crisis, and so unfortunately, I have a lot of experience supervising and evaluating institutions under adverse conditions.

Based upon our review, we believe H.R. 1418 is sound public policy, and I urge its timely adoption. Consider the following: The Nation's economy is clearly in need of added small business lending in order to stabilize the economy, ease the unemployment crisis, and provide a foundation for future economic growth. H.R. 1418 will allow the redeployment of existing credit union capital to member business lending, thereby increasing the amount of available lending to this important economic segment. This action does not require any financial contribution by the Federal Government.

Of the Nation's 7,300 credit unions, only about 2,100 engage in member business lending; and it is true, it is done by the larger institutions that have the capability to do this to the extent necessary to create the necessary infrastructure to do it in a safe and sound basis. My written testimony shows the breakdown of member business lending throughout the country.

This has become an important part of credit union loan portfolios, and as Chairwoman Matz said, will diversify those portfolios and allow them to be safer and sounder in the years to come. It represents $32.3 billion in lending currently, and that is about 5.65 percent of total credit union loan portfolios.

The history of member business lending is it has been done safely and soundly since the 1998 cap. The delinquency rates, as noted before, are actually less than this type of lending in the banking community. We believe the added capacity will be done again in a safe and sound manner.

Credit unions only have a small section of this market, and they should pose no competitive threat to the banking industry, even with this modest increase. In any event, competition is very good for both industries and good for the consumers.

We believe that this bill will give credit unions the necessary tools to succeed and prosper in the years to come, that it will reduce the NCUA's insurance risk and, to a far smaller extent, the insurance risk of MSIC. A prosperous credit union industry is good for consumer lending.

Credit unions did not participate in predatory consumer practices during the past 5 years, and they will not engage in those types of activities as they expand their member business lending. We believe this is sound public policy. It will be an important tool for credit unions and will help us create jobs in the broader economy.

Thank you, Madam Chairwoman.

[The prepared statement of Mr. Hanson can be found on page 70 of the appendix.]

Chairwoman CAPITO. Thank you.

I want to thank the panelists, and guess I don't have to ask the bankers and the credit union folks to tell me what you really think. I have a couple of questions.

Mr. Grinnell, you mentioned that you had $300 million—first of all, let me ask you, on the Wilmington, North Carolina, I am going to assume you have a Corning Credit Union facility there?

Mr. GRINNELL. Yes, we have three branches there.

Chairwoman CAPITO. Three branches. So that is why the mayor would be approaching you. You mentioned you have $300 million to lend. Is that taking into consideration all of the capital requirements and other such things that are written into this bill that would require you to hold more capital, etc.?

Mr. GRINNELL. The $300 million is the excess cash that we have from our depositors. If the cap were lifted for us, that would mean we could make about $135 million in additional commercial loans. The point with the extra $165 million in that number is the bankers' claims that this would take away from consumer lending. My point with that is we still have over another $100 million to focus on our other members, to make car loans, and to make mortgage line loans, like we always have.

Chairwoman CAPITO. But your member business loan would be less than half of that of $300 million?

Mr. GRINNELL. Correct.

Chairwoman CAPITO. And then, Mr. York, in your figure, the $13 billion in capital for small business lending, is that figure—and I know you didn't reach this figure yourself—but is that figure, is that for just the people doing member business lending now, or is that for every credit union, or do you know?

Mr. YORK. That would include the credit unions that are going to enter the market because the cap is lifted, as well as the credit unions that are invested in member business lending currently.

Chairwoman CAPITO. So do we know, is that 100 new credit unions? I am sure it is an approximation.

Mr. YORK. There are numbers in my written report that show that.

Chairwoman CAPITO. Okay. Mr. Marranca, your testimony was pretty much in direct conflict with what Mr. Grinnell and Mr. York testified in terms of whether you are competing and taking business from banks. You have said basically you feel that credit unions in your small community could and would and maybe are—credit unions are providing or are able to offer, I think you said, a more favorable rate. How would that go? They can offer lower interest rates? Or how are you seeing them being a threat to you in terms of competition? Do they undercut you? You mentioned nonmember business loans, which you heard me ask the chairwoman if that was possible. So I would like to have your response to that.

Mr. MARRANCA. I would be pleased to answer your question. I have to correct one statement that was false, first, with the approval of the committee.

Chairwoman CAPITO. Go ahead.

Mr. MARRANCA. It was stated by the spokesman from the credit unions that Subchapter S banks do not pay taxes, and that is false. That is misinformation. I believe they stated they did not like misinformation. Subchapter S banks pay taxes. There are 2,300 Subchapter S banks that pay taxes. It is brought down to the personal level of the individual owners of the bank, and they pay Federal and State taxes at up to a 30 or 40 percent level. I would invite any credit union to pay any Federal or State taxes at that 40 percent level.

To answer your question, how are they a threat or a competition?

Chairwoman CAPITO. Right. And you mentioned undercutting, too.

Mr. MARRANCA. They are a tax-subsidized business that competes directly with me. If one of you owned a dry cleaner shop or a restaurant or a car dealership and your competitor across the street did not pay taxes, you would be at a disadvantage. That is the disadvantage I am at. If you are allowing greater powers to an organization that already has a competitive advantage to me, that puts me even at a greater disadvantage. I am a small business.

Chairwoman CAPITO. Do you do these small business loans, under $100,000?

Mr. MARRANCA. We have absolutely zero cutoff. We will do any loan. I will make an arbitrary number of $1,000 and up. We are a small community bank with a $100 million loan portfolio. Of that portfolio, approximately $45 million of that is commercial loans. There is no limit on the size of the loan. So I disagree that there is a need for this legislation because of size of loan.

Chairwoman CAPITO. Okay. Thank you. Gosh, I have so many different questions.

Mr. Grinnell, again, if the credit unions begin to focus more on business lending, do you think that there is any danger that they would focus less on consumer lending, or would it just be more—I don't know, answer that.

Mr. GRINNELL. I can speak for our credit union in saying, absolutely not. As I had mentioned previously, we have plenty of cash from our depositors to make all different types of loans and meet our members' needs. We also are in business to serve all of our membership, and when you figure that, even with business loans right now, it is about 10 percent of our assets, if we only focused on 10 percent of our business, we would not be in business for long.

Chairwoman CAPITO. Right. Are you in the top 100, or 500 largest credit unions?

Mr. GRINNELL. I think we are about number 200 out of the 7,200.

Chairwoman CAPITO. I believe I am out of time. So, Mr. Scott for questions.

Mr. SCOTT. Thank you, Madam Chairwoman. This is very interesting. It is a good hearing.

Let me start with you, Mr. York. What is the typical loan size you service and the delinquency rate of your portfolio?

Mr. YORK. Our average loan is just below $200,000. We do not have any delinquency at this time.

Mr. SCOTT. Okay. And what would you say is the number one myth behind your ability to loan to the communities you serve in?

Mr. YORK. The number one myth would be that we aren't sophisticated enough to make these types of loans, and we certainly are. We have built a program that you can see in our delinquency and charge-off ratios that has been very successful. Our vision is to make a difference in our neighbors' lives, and we do that on a regular basis by making loans to our community, whether it is business loans or home loans or car loans.

Mr. SCOTT. And would you explain the current net charge of rate for these loans?

Mr. YORK. The current charge-off is an average of less than 50 basis points, less than one-half of 1 percent.

Mr. SCOTT. And how would that compare to the remainder of your portfolios?

Mr. YORK. It is about the same.

Mr. SCOTT. Okay. Now you, and I guess Mr. Grinnell, you are saying that you are going to bring in, what is that, $13 billion, $14 billion into the economy, 140,000 jobs?

Mr. YORK. That is correct.

Mr. SCOTT. Now, how do justify that? How do you know that?

Mr. YORK. As you look at the capacity for the credit unions that are in business lending today, by lifting the cap, you will have the capacity—and it is a very conservative number, but the capacity to take on more small business loans. And then you have new entrants into the market, the smaller credit unions that will enter because the cap is lifted. There is some further detail in my written statement. It is 30 pages, but it is a very conservative estimate.

Mr. SCOTT. It might be good as we move along, that when you put those figures out like that, especially because jobs is the number one issue we are faced with—

Mr. YORK. Absolutely.

Mr. SCOTT. —and we are doing all we can to create those jobs. We want to make sure that those numbers are justified, that we have some factual—if it is less than that, whatever that accurate figure is, and the justification for that, because I think—

Mr. YORK. We have all that.

Mr. SCOTT. —the core of how we move with this legislation is going to be judged upon that issue of demand and the benefit and what it will do, and particularly when you lay it on jobs—and that is what we need—we want to make sure we have something solid to hang our hats on.

Now, Mr. Marranca, I think you made the point that—how would you argue with the credit unions who argue that their member business lending has increased substantially, about 40 percent since the economic crisis, whereas bank and commercial lending has decreased by as much as 14 percent? If that is true, it might justify some demand for this legislation. So can you comment on why this might be and why you believe credit unions should not be able to meet a need that the banks are not meeting?

Mr. MARRANCA. Congressman, I can only speak for my community bank, and I have spoken to hundreds and hundreds of community bankers throughout the country in my role as chairman of the ICBA. I can tell you that my community bank stands ready and willing to lend money to anyone at any time for any creditworthy purpose. I have to put on $1 million a month in new loans just to maintain a level $100 million loan portfolio that I have right now. I am having an extremely difficult time doing that.

I do not turn my back on my borrowers. We established relationships with my borrowers, whether it is a personal borrower or business borrower, in good times and in bad. That is how we have been in business for over 110 years. It is a lack of demand, sir.

A recent survey just came out by the National Federation of Independent Businesses that said, the Small Business survey, access to credit is not an issue. It is poor sales and poor business. I don't have one loan to any one borrower that is to a national stock firm at all. It is to mom-and-pop operations. It is to sole proprietors. It is to individual owners, and every one of them is basically hunkering down. This is not the time to go out and employ more people or expand more businesses.

Mr. SCOTT. Let me ask you something. I really need to get this question in just right at the end here. What I am trying to get to is, have you in your, either of your banks, Mr. Kelly, turned down a small business person seeking a loan, and that person had to go to a credit union to secure that business loan?

Mr. MARRANCA. I am aware of one person in my 30 years of being at the bank that we have turned down, and they went and acquired a loan at a credit union. That had to do with the credit quality of the loan. We are in a very difficult environment of overregulation and undue regulation and disconnect of the examiners in Washington. We have to very carefully underwrite the loans that we do so that we have the risk and the reward.

Mr. KELLY. Congressman, may I respond?

Mr. SCOTT. Yes.

Mr. KELLY. I believe that from our standpoint, we are in low- to moderate-income areas in much of Oklahoma. Our mission has been to try and create jobs in those areas. We try every day to find ways to loan, either to create a job or to keep a job. And what we have seen, not that we have customers who are fleeing the credit unions, but we have customers we try to give a solution to as to how we can make the loan that comes to us. If we can't make it, I will tell you that in my opinion, it can't competently be made.

I believe that banks across this country are sitting with cash, wanting to invest. The problem is not so much trying to find the available credit. It is finding small businesses that aren't being strangled today by the regulations, by all of the different things that come down through Washington. I have customers who are saying, I am considering just quitting, because I have this regulation and this regulation and this regulation.

From the standpoint of Mr. Marranca and myself, we are getting ready to have the other 94 percent of Dodd-Frank hit us. It is a very, very expensive thing for small community banks such as ours, but we will continue to lend. We are going to continue to build our community. That is how we make it.

Chairwoman CAPITO. The gentleman's time has expired.

Mr. SCOTT. Thank you.

Chairwoman CAPITO. Mr. Renacci?

Mr. RENACCI. Thank you, Madam Chairwoman.

I want to thank all the witnesses today. I am still trying to figure out the demand question. You have probably heard it now 25 times: Demand, demand, demand. It appears what we have here is we don't have the demand because the economy is not growing. We need the economy to be growing to get the demand, and then what the credit unions would be doing is going after some of the loans that the banks aren't doing, so you are really fighting for all the same loans, because if demand was growing, I would hear it, and in the testimony of the previous witness, I think a couple of us asked, where is the demand? Where do you see the demand? I have heard a couple of you say that you personally, your banks and your credit unions, have demand.

My question is for you, Mr. Grinnell. If you have that much demand, why don't you convert to a mutual bank charter?

Mr. GRINNELL. I don't want to be a bank.

Mr. RENACCI. Why don't you want to be a bank?

Mr. GRINNELL. We like being a credit union. We like being focused on our members. We want to focus on our members. We don't want to focus on stockholders. We feel that is what we are good at, and all we want to be able to do is basically use our money, our depositors' money, not the government's money, to make additional loans and invest in our communities. And we do have demand. As I mentioned in my testimony, I have letters here from members. I have a letter from the mayor of Wilmington, North Carolina.

Mr. RENACCI. I understand that, but you could, if you converted to a mutual bank charter, take care of that demand, correct? I know you don't want to.

Mr. GRINNELL. I am not an expert on the mutual bank charter, but we want to remain a credit union.

Mr. RENACCI. Okay. And one other thing before I move on, you did make a comment which caught my attention, too, that the banks, that some of these Subchapter S banks are not paying taxes. I am a CPA, and I would also agree, and I am assuming you would now agree, too, that Subchapter S's do pass on their earnings to their shareholders and they do pay taxes, so the Subchapter S banks would be paying taxes; is that correct?

Mr. GRINNELL. The bank themselves, from what I understand, do not pay taxes, they just pass it on to the shareholders, and credit unions, when we pass dividends on to our members, they pay taxes on those as well.

Mr. RENACCI. But banks, Subchapter S banks could pay up to 35 percent, their shareholders could pay up to 35 percent. You don't have to answer the question, but as a CPA, I can tell you that is the case.

Mr. York, you talked about jobs, and I know that is key, jobs are important, but if the demand for the small business owner is not there, you are lending to a small business owner, who is going to build jobs, who is going to increase his jobs; is that correct? That is what you are talking about, the ability to loan out to a company, a small business which is going to create a job; is that correct?

Mr. YORK. Yes.

Mr. RENACCI. So, without that demand, you are again fighting loans that maybe a community bank could also be lending to. Would that be correct?

Mr. YORK. Not necessarily. We do have that demand, and especially in our area, we are seeing a shrinking number of banks in our area, community banks, and being taken over by larger conglomerates, and there is definitely a demand in our area. We are asked for business loans just about every day.

Mr. RENACCI. Mr. Marranca, I will go back to you then. Are you telling me that you are turning away customers who are coming to your bank? I think I heard you say there might have been one?

Mr. MARRANCA. If I was turning away customers coming to my bank, I would not have been there for 30 years, our bank would not have been there for 110 years, I would not have grown the bank over 30 percent in the last 4 years, no, sir. We have commercial lenders who are out beating on doors every day, trying to make loans, whether they are consumer loans, commercial loans. I have to put my money to work, too, and the only way I can put my money to work is the old-fashioned way, and that is by making loans. I cannot create loan demand. I can just be there ready and willing to lend when it is available.

Mr. RENACCI. Mr. Kelly, I am all for competition. Can you tell me why your bank can't compete with the credit unions?

Mr. KELLY. I think that it is a matter—the banks compete with credit unions daily. The GAO had a report not too long ago that showed that banks served more low- to moderate-income people than credit unions did. We compete with them every day; we are forced to compete with them. They have expanded in almost invisible fields of membership for some of these, some of these very large ones that make it difficult, but the fact of the matter is when we have a situation where we are starting to run a hundred yard dash, we start on the goal line, and they start on the 40 yard line. Because we have to pay 40 percent tax wise before we can even get to that point, it makes competition very hard.

I would also tell you that I think that the reason someone, with respect to Mr. Grinnell, doesn't want to convert is because he doesn't want to pay taxes when he can get this kind of an exception and take the customers and not pay taxes on them, and I would tell you, we are focused on our customers, not just on shareholders.

Mr. RENACCI. I know I am running out of time, but in conclusion, I would hope if somebody could get me information on demand, because I am all for competition. I am all for listening to both sides and hearing the credit union's side, but I still—nobody has given us today, I have not heard anything about how demand is increasing and how credit unions can compete with banks on a fair and even plane to cover that demand. Thank you.

Chairwoman CAPITO. Thank you.

Five minutes for Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

Mr. Grinnell, I am kind of curious here. Looking at your Web site, you say that you have 79,000 members worldwide, branches in 3 States. You charge ATM and other service fees. Your Web site claims that you have expanded your field of membership to include more than 1,000 employer groups and associations as well as businesses. Among your employer groups are All Points Taxidermy in Greencastle, Pennsylvania; Aniello's Pizza in Corning, New York; and Creative Minds Preschool in Wilmington, North Carolina. Can you tell me how in the world you can have a community of interest that large for a credit union?

Mr. GRINNELL. Those employer groups that you mentioned, they are all of our employer groups, and I am proud to say that we serve all of them.

We were originally chartered to serve Corning Glass Works, which is now Corning, Incorporated. They are a Fortune 500 company located in various markets throughout this country. We expanded along with Corning into North Carolina and into Pennsylvania; that is why we have branch presence in those markets.

Since that time, certainly just from a diversification perspective and a safety and soundness perspective, we have expanded within each of those markets in North Carolina, Pennsylvania, and New York, to add additional employer groups, like you mentioned.

Mr. LUETKEMEYER. Okay. Do you participate any loans out?

Mr. GRINNELL. Sometimes, yes.

Mr. LUETKEMEYER. Mr. York, do you participate any loans out?

Mr. YORK. We have not participated our own loans, no.

Mr. LUETKEMEYER. Why not?

Mr. YORK. We haven't found the need to yet.

Mr. LUETKEMEYER. You are not at your cap yet?

Mr. YORK. Not even close.

Mr. LUETKEMEYER. Therefore, you don't need to do that?

Mr. YORK. We are a little over 50 percent.

Mr. LUETKEMEYER. Mr. Grinnell, are you at the cap yet?

Mr. GRINNELL. We are getting very close; we are at about 80 percent of the cap right now.

Mr. LUETKEMEYER. Is that a viable alternative when you reach the cap?

Mr. GRINNELL. No.

Mr. LUETKEMEYER. Why not?

Mr. GRINNELL. We have been focused much more on participations over this last year and have found it to be a very inefficient and time-consuming process. Not only does it hold up getting a loan closed for our member—it sometimes takes over a month to get a loan closed—but also the time and effort, just from a pure business perspective, the time and effort that goes into that just from a profitability perspective does not make sense.

Mr. LUETKEMEYER. That is interesting, because that is the way a lot of banks manage to go around their loan limits is to be able to participate. I think it is a great way to be able to service your customers. I think it is amazing that you are being so single-minded about it.

Mr. GRINNELL. No, no, it is a very difficult—

Mr. LUETKEMEYER. One question for you.

With regards to a statement in your testimony here, you make a comment with regards to the Communities First Act, which I happen to be the sponsor of, and you say that one approach is the fair relief that would be all, to all would be to both—would be to combine both bills and pass as a package. While this may not be the first choice for banks and credit unions, it may be a fair compromise in aiding our Nation's community institutions and job creation and putting job creation first. Failure to consider raising the member business lending cap for credit unions while at the same time advancing H.R. 1697, which is the Communities First Act, and its provisions would likely lead to public opposition by the credit union association, the entire credit union community, its members, and small businesses.

That is kind of interesting. I thought you were going to put job creation first, and now we are going to oppose the very bill that you were going to use as a vehicle?

Mr. GRINNELL. I think—

Mr. LUETKEMEYER. In your testimony a minute ago, you said, "Who could be opposed to that?"

Mr. GRINNELL. I think both of those bills, from what I understand, both H.R. 1418 and the Communities First Act, are designed to decrease regulation and to help encourage lending in our communities.

Mr. LUETKEMEYER. Would you be supportive of the Communities First Act if we didn't get this bill on it?

Mr. GRINNELL. I don't—I am supportive of additional lending for our communities, but I also think this is—we all know this is a bank versus credit union issue, and we are supportive of trying to get these moved together.

Mr. LUETKEMEYER. There are a lot of credit unions—

Mr. GRINNELL. We are supportive of getting both of them done at once to help the communities that we serve. The fellow next to me mentioned they want to do additional lending, they want to make all the loans they can, and we are very supportive of that.

Mr. LUETKEMEYER. Okay, quick question for Mr. Kelly and Mr. Marranca. What percentage of your assets do you have in business lending right now?

Mr. MARRANCA. We have a 65 percent loan-to-deposit ratio. That would equate to approximately a 45 percent loan-to-asset ratio.

Mr. LUETKEMEYER. Okay, business loans?

Mr. MARRANCA. Of those business loans, of the $100 million loans representing 45 percent, just about half of those are commercial business loans, small business loans.

Mr. LUETKEMEYER. Okay, so would what the percentage be then of your total assets?

Mr. MARRANCA. To assets, approximately 25 percent.

Mr. LUETKEMEYER. Okay, so they want to be able to lend more than what you do.

Okay. Mr. Kelly, what is the percentage of—

Mr. KELLY. Our percentage that is tied to commercial lending, business lending, would be in excess of 60 percent.

Mr. LUETKEMEYER. You are 60 percent business loans?

Mr. KELLY. Yes, sir.

Mr. LUETKEMEYER. Really? You are servicing your community, there is no doubt about that.

With that, I will yield back.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. Thank you.

Mr. Sherman, for 5 minutes for questions.

Mr. SHERMAN. Thank you. This bill may be the only thing this committee actually passes into law that creates jobs. Congress is pretty much locked up. This is I think the only pro-jobs bill that has substantial numbers of Democrats and Republicans both co-sponsoring it.

And I realize there is a place for commercial banks as well in making commercial loans. I just haven't met a single small business person in my district who said, don't let the credit unions make loans to my business because I am sure that some day the banks are going to approve the loan, I know, some day. The more lenders, the better it is for small banks—for small business rather.

Now, Mr. York, I think you are at 50 percent of your cap, so some people would just say, well, hey, this cap isn't affecting you. How has the cap affected you, and has it caused you to turn down small business loans?

Mr. YORK. Luckily we haven't had to turn any down yet, but we do review this on a regular basis. We have to be mindful of the cap. We know it is out there. We certainly want to be a resource, a continued resource for our business members. If we get closer to the cap and/or hit, bump up against the cap, we are not going to be able to be there for their existing members, let alone any new members that wanted to join and take advantage of those loans.

Mr. SHERMAN. Are you able to gear up to make business loans to hire the loan officers who understand business lending, knowing that if that person is successful, they are going to hit the cap?

Mr. YORK. Yes, that is a challenge for us right now. We certainly could ramp up and hit our cap in a very short period of time, but we have chosen not to do that.

Mr. SHERMAN. If we do pass this bill, are you going to expand your business lending?

Mr. YORK. Absolutely.

Mr. SHERMAN. Okay. Do you have any borrowers now who say, thanks for the loan, but I really wanted it from a commercial bank instead of a credit union?

Mr. YORK. We have not heard that one yet, so we are waiting for that.

Mr. SHERMAN. I will be back in my district next week. I will talk to a lot of small business people, and we will see whether they want to prevent a major avenue of small business lending on the theory that some other institution should do it.

Now, you pointed out that nearly 70 percent of the credit unions don't engage in any business lending. Why are there so few that make business loans? And I think we have talked on it a little bit, and that is you would have to gear up to be able to do it, but why are so few credit unions making business loans now?

Mr. YORK. The smaller credit unions know there is certainly a cost to enter this business. You have to gear up for that and pay for that. Knowing there is a cap out there, you are certainly not going to do that if you are not going to be able to have a sustainable business model that will take you forward. These credit unions have chosen not to participate in business lending for either that reason, or it is not in their goals or business model.

Mr. GRINNELL. If I may, Congressman, Chairwoman Matz had pointed out that credit unions, $45 million and under in assets, that represents about two-thirds of credit unions across the country, and those are very small credit unions, so it just doesn't make economic sense for them to hire that kind of expertise to be able to make between $5 million and $6 million in loans, but two-thirds of all credit unions are $45 million or less in assets.

Mr. SHERMAN. Even if you were making 2 or 3 percent spread on those loans net, if you are only making $5 million or $10 million in loans, it is hard to pay for a full-time loan officer, let alone the oversight supervision that we would like to see in intelligent lending.

What about your credit union, how are you affected by the business lending cap?

Mr. GRINNELL. We are right now about 80 percent of our cap, and we have—back to the demand question that has been mentioned several times, we have very strong demand in both of our markets. We are anxious to serve our members. We are anxious to help our communities. If this cap is not lifted, we are going to begin turning members away sometime next year. We already don't promote our program, and unfortunately, it will go from that to actually turning people away. And we have, as I mentioned before, a hundred, if the cap gets lifted, that would give us another $135 million, which I don't think is a small amount for the communities.

Mr. SHERMAN. Speaking to the credit union representatives, do you oppose any legislation that is designed to get, allow or help commercial banks from making more small business loans?

Mr. GRINNELL. No, I tried to say that before, but absolutely not.

Mr. YORK. Not at all.

Mr. KELLY. Congressman—

Mr. SHERMAN. Mr. Kelly?

Mr. KELLY. If I might just respond to your question about that you hadn't had anyone in the credit union saying, I really want to get this from a commercial bank. I haven't had anybody in my bank say, I would really rather have this loan from a credit union.

Mr. SHERMAN. I don't know your part of the country, but I have 1,000 different business people just in my district who have come to me and said, I didn't get the loan from the bank; I wish I could have gotten it from the credit union. I am sure the business people I talk to would be happy to get the loan from any one of the people who are up there, and if you want some Los Angeles business, see me after the hearing.

Mr. KELLY. I might want to do that. I do want to point out that maybe—

Chairwoman CAPITO. The gentleman's time has expired.

Mr. SHERMAN. My time has expired.

Chairwoman CAPITO. Mr. Huizenga for 5 minutes.

Mr. HUIZENGA. Thank you, Madam Chairwoman.

I appreciate the opportunity to peer into the spitting match that goes on here in Washington. It is good to know when I served in the Michigan legislature, that wasn't just a unique microcosm. This is a national issue between the banks and the credit unions.

So I hear a lot of testimony, and quite honestly, I think you both have some very salient points as you are moving into this. I think that, as my colleague from California was starting to talk about, there is a credit access problem.

I happen to believe one of those barriers to banks being able to make those loans is the Dodd-Frank Act that this committee passed, and I will give a specific example on that: A family-owned business that has a piece of property in Michigan with a $1.2 million value has a $120,000 loan on that, has a 5-year balloon, and based on the regulators now coming into that bank, which this family has had a 30- to 40-year relationship with, those regulators are saying, oh, real estate holdings in Michigan? Thanks, but no thanks, you have to move those off your books.

Fortunately, that banker happened to have a very good relationship with one of their local credit unions and pulled that family in with their credit union. And I think that happens more often than maybe what people care to admit, but you had a banker and a credit union member or a lender sitting at the same table in a bank trying to make sure that their customer was being serviced. And that was directly tied to Dodd-Frank and some of the regulatory issues that were coming in.

So that is an ongoing concern that I have as a member of this committee and something that we need to do, and I think something that can change.

I am seeing both heads nod.

Madam Chairwoman, just for the record, we have banks and credit unions agreeing.

So I am glad I could be a unifier here.

I do sort of want to touch on a little bit with my friends from the bank here, we heard the regulator from the credit unions, so sorry, Deborah Matz, earlier, who was addressing sort of the safety and soundness concerns. She doesn't believe that is particularly valid. I think anybody who has looked at this sees that there are advantages to being a credit union. There are advantages to being a bank for different things that you are trying to do.

I guess what I am trying to get at as a member exploring this issue, is there really a need for the increase in the cap or not?

And I guess I would ask Mr. Marranca and Mr. Kelly this specifically. If there is no need, because there is sort of this lack of demand element, then really is there a harm in authorizing that cap to be lifted if you are really not losing that much business to them? And I understand there may be particular instances. I experienced that one firsthand as I was sitting, witnessing this particular transaction. I know there are times that occurs, but where is the particular harm that could come out of this?

Mr. MARRANCA. Congressman, in my opinion, it is a zero-sum game when you ask, is there a need? It is not an issue of demand. It is a zero-sum game. Any loans that will go into a credit union, which would be taken from a bank or a community bank. They would be taken from a bank that pays taxes. You are not going to create new loan demand when the demand is not there. I heard—

Mr. HUIZENGA. I am going to interrupt for one second here. I know, being a small business owner myself, if I have an institution that can't particularly make that one loan come together, bank, credit union, whatever, as long as I grow my business, guess what, I will have eventual demand. And so, I think there is something to be said about growing the size of the pie in general here, and this bill may do it. I don't know, but go ahead.

Mr. Kelly, I know you wanted to jump in.

Mr. KELLY. Thank you, Congressman.

The thing that I would say is, I would go back to my original testimony and point out that there is an ability right now for these credit unions to convert to mutual charter. When we see the association that Congressman Luetkemeyer addressed, as far as all these common bonds that aren't really common, we go out and look at the billboard in Los Angeles that said, can you join? And the answer underneath is, are you breathing? We are prying under a charade now that the credit unions really serve this common bond, and it is not really the case. And so my colleague here is talking about the fact that we are not talking about the American Airlines Credit Union that serves everybody associated with American Airlines. And we bless that and say good luck, keep going.

We are talking about moving into the commercial field, which takes away, which puts a complete disadvantage there and also takes away from the bank's ability to truly be able to go out and have a level playing field of trying to get those loans and service those loans.

At the conclusion of my testimony is a list of the credit unions that have recently failed because of their commercial lending forays, and I just ask you to look at that. I also have a quote from Dale Kerslake, who is the president and CEO of Cascade Federal Credit Union in Kent, Washington, who basically says that the majority of credit unions do not want or need this type of legislation, and I would just call that to your attention.

Mr. HUIZENGA. I appreciate that, and I know my time has expired, but there have been plenty of banks and credit unions that have gone out of business because of this particular job environment, and that is what we are trying to change and turn around.

Mr. KELLY. Thank you, Congressman.

Chairwoman CAPITO. Thank you.

I would like to thank the panel. I have an additional question, and Mr. Scott would like to ask an additional question if you would just bear with us here.

I wanted to ask Mr. Hanson, what is your perspective on the National Shared Insurance Fund? If this cap were to be expanded, would it have any influence on it? Would it have any influence on what was required of the participation of the credit unions that pay into this fund? I know you managed the one for the State of Massachusetts.

Mr. HANSON. I think the NCUA has done a very good job so far in managing and supervising the member business lending under the existing cap, and I think that their regulatory approach has worked quite well, as we can see from the delinquency numbers. So I don't think that increasing credit union member business lending will impose any additional risk on the fund, and in fact, the diversification of those portfolios is a very big and important issue, especially given the fact that mortgages are now at 40-year generational low interest rates.

As interest rates rise, mortgage loan portfolios will carry interest rate risk, and so it is very important for credit unions and all community financial institutions to diversify their portfolios so that they will not have future interest rate risk. So this action, I think, will actually help and will ease the stress on the NCUSIF.

Chairwoman CAPITO. Thank you.

Mr. Scott?

Mr. SCOTT. Thank you, Madam Chairwoman.

In listening to this debate and this discussion and debate between you, it seems to me that what all of this is boiling down to is competition, and I think that it would be very important for us to ask the question of each of you because, Mr. Kelly, I believe it was, you made a statement, you said something relative to shifting of tax-impacted loans to tax-exempt loans. So I would like for each of you to answer the issue about this competitive edge of credit unions having the tax exemption status, how that relates—and I think it is very important for the credit unions to give us a good answer on this, because I think that all this is weighing in on this competition between banks and here.

The increase from 12.2 to 27.2, I believe, is a sizable increase here, so I think that as we evaluate this and look at it, I think some of this is going to come on, where does this lay? Is there an advantage? What is this about the tax-exempt status? And let's deal with this issue; is this an issue of competition here? Because we are trying to get demand, we are fuzzy on that. It is going to create jobs. It is going to create 250, and it is based on this or that. So is this somewhere where the rubber meets the road that you feel it is unfair for the credit unions to have this tax-exempt, and then they get in your bailiwick, and the credit unions are saying we have this demand, and we have a not-for-profit status that goes along with this? So could each of you give us your opinion on this whole issue?

Mr. MARRANCA. Congressman, I am not afraid to compete. I compete every day. I have been in the bank for 30 years. Before that, I was an FDIC bank examiner. I believe in safety and soundness, and I believe in taking care of the communities we serve. My main office has been located 110 years in a town of 800 people.

We have to be very careful about lumping all banks together versus lumping community banks, which are over 7,000 in this country, who believe strongly in Main Street America, relationships, taking care of our customers and business customers.

I will compete up against anybody, megabanks, credit unions, other community banks, but they have a competitive advantage when they want to be a bank, look like a bank, smell like a bank, but don't pay taxes like a bank, and now they want more powers. That puts me at an even greater competitive advantage. They don't have CRA. They don't have the FDIC regulators. They, if they want to be a bank, can be a bank. If you don't want to be a bank, remain as you are, but you have a competitive advantage. I bet you there are thousands of credit unions who right now are afraid of what might happen when you open this bottle. I am not afraid of competition. America is built on competition, but it is also built on fairness and a level playing field.

Mr. KELLY. Congressman, I think that I would second what Mr. Marranca said, but I would tell you that from my standpoint, I can give you an example of a California credit union that is an entrepreneurial credit union that has come in and made a loan in Tulsa, Oklahoma. I think we could show you example after example after example of those kind of things going on, of out-of-State credit unions coming in and making commercial loans.

The reason I bring that up is because that is really a pretty small percentage of the credit unions that are out there. The traditional credit union, the traditional one that really intends to cover that core group of people who work at American Airlines or that are truly the East Central Teachers Credit Union, of which there is one, those are there for a purpose. They stay within their bounds, but when we start seeing credit unions expand beyond State lines, expand into every possible profession that there is, it is fine to stand behind that and say, you know that I am a credit union, and I can offer 3 percent lower rates, and I am not really covered by FDIC and tough Dodd-Frank regulations.

Mr. SCOTT. I don't want my time to expire without giving the other side an opportunity to respond, so could I hear from the credit unions?

Mr. GRINNELL. I would like to respond, thank you, I guess with a couple of points. The banks say that we have this huge advantage and the tax advantage is always thrown in there; it is not a level playing field. And I guess I would say if the advantage is that significant and that much of a competitive advantage, why do we only have 5 percent market share in business loans?

I guess I would also say that, if the advantage is that significant, then why don't we see banks converting to credit unions?

And then, lastly, when we have new members come in our doors for commercial loans, it is not because we have better rates. It is not because we have some tax advantage. It is for one of two reasons. First, again, I have letters to show that the banks were not willing to help these members; they did not have the money to lend to these members. Second, the other reason that we see is that the banks are more focused on their stockholders than they are taking care of their customers.

Mr. SCOTT. So you do have evidence where people have been turned away from banks?

Mr. GRINNELL. Yes, I do. AsI said before, I would like to submit that into the record.

Mr. SCOTT. Mr. York?

Mr. YORK. Thank you for the question. First of all, we are tax-exempt because of our structure, we are a not-for-profit financial cooperative. That is different than a bank structure. And there is nothing wrong with that. It is okay that we have two different structures.

They are beholden to their stockholders; we are beholden to our members. We are here to serve our members. That is our mission, to serve our members, whether they are of modest means or not, we serve our members. And we do that with consumer loans, home loans, and business loans. So it has nothing to do with our tax-exempt status. We have a different structure.

This shouldn't be about our taxation or tax status. It should be about creating jobs. It should be about businesses and helping the economy, and that is what we both have said for this entire time, and we look forward to a positive result.

Mr. HANSON. I will be brief.

These are really two different industries. Credit unions are tax-exempt because they go places that other financial institutions don't go, and they serve people who need those resources, and that really is the heart and soul of the industry.

This isn't about competition. The fact of the matter is, all the credit unions in the Nation have about $950 billion in assets. That is less than the balance sheet of Citibank.

We serve people who need these services, and we are really a different industry. And we are going to deliver member business loans to help improve the economy as demand improves, and so as a result, I think the issue is clouded when it is looked at a competitive issue with credit unions and banks. This is not a zero-sum game; this is about increasing the pie and delivering financial services to those people who need them.

Our largest credit union, Navy Federal Credit Union, is that way because it went places no one else would go. Thank you.

Chairwoman CAPITO. Thank you, and I am going to give Mr. Luetkemeyer 5 minutes if he has any additional questions.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman, just briefly.

Mr. York, what is the interest rate that you charge on your auto loans?

Mr. YORK. Right now, it is 1.99 percent.

Mr. LUETKEMEYER. What is the rate that you charge on your home loans?

Mr. YORK. It is market rate, Fannie Mae, Freddie Mac rates.

Mr. LUETKEMEYER. Four percent, 4 and a quarter?

Mr. YORK. Sure.

Mr. LUETKEMEYER. What is the rate you are charging on your commercial loans?

Mr. YORK. It depends on what type of loan it is. Real estate, it could be 6 percent.

Mr. LUETKEMEYER. Six percent.

Mr. Grinnell, what is your rates on auto loans?

Mr. GRINNELL. I believe the car loan rate is around 2.5 percent.

Mr. LUETKEMEYER. Two and a half. Home loans?

Mr. GRINNELL. Again, whatever the market rate.

Mr. LUETKEMEYER. Okay, commercial loans?

Mr. GRINNELL. Depending on the type of deal, the structure of the deal, anywhere between probably 5.5 and 6.5 percent.

Mr. LUETKEMEYER. Okay.

Mr. Kelly, what is your rates?

Mr. KELLY. On our auto loans, which would be consumer loans, we would probably be in the neighborhood of 5 percent. Commercial loans, we would be usually priced off of national prime somewhere 4.5 to 5 percent, and we operate most of our, most of the loans today go into the national market, so we price our home loans based on the national market rates.

Mr. LUETKEMEYER. Okay. Mr. Marranca?

Mr. MARRANCA. Our car loans would average between 4 and 5.5 percent, depending upon the term of the loan, our mortgage loans would be the national rate, Fannie Mae and Freddie Mac, with the exception of we also make loans that we hold in our own portfolio for approximately one-third of our customers who do not qualify for Fannie and Freddie, and that would have a premium on them because we are holding those in our portfolio. Our commercial loans are totally negotiable based upon the strength of the borrower and the balance sheet, but would average between 4.75 and 6.5 percent.

Mr. LUETKEMEYER. Okay. What is interest rate reflective of?

Mr. MARRANCA. Pardon?

Mr. LUETKEMEYER. What is the interest rate reflective of?

Mr. MARRANCA. Market competitive factors.

Mr. LUETKEMEYER. Risk, right?

Mr. MARRANCA. And risk/reward, absolutely.

Mr. LUETKEMEYER. It is interesting. I know Chairwoman Matz, and Mr. Hanson, you made a comment a while ago that it is important to diversify your portfolio. And I don't disagree with that, but it is interesting that we want to diversify in a more risky area. And I want you to just think about that for a second. Be very careful where you want to tread because you are going in a direction that has a lot of pitfalls in it, and that is the only comment I have to make.

Mr. MARRANCA. Congressman, if I may quickly, I heard today the national credit union regulator say, and it frankly astounded me, that for the sake of safety and soundness, they want their organization to diversify into the most risky loans you can make for diversification and safety and soundness. And I can tell you I have never heard an FDIC Chairman say, I want you to make more commercial loans for diversification or safety and soundness.

Mr. LUETKEMEYER. As a former regulator myself, this is the wrong direction to go to if you are looking for safety and soundness.

Thank you, Madam Chairwoman.

Chairwoman CAPITO. I thank you, and I thank the Members, and I want to thank the panel for the lively discussion and great details which you provided in your answers. I would say, anecdotally, it is like Mr. York said, it is all about jobs. And we have to find a way to get America back to work.

The Chair notes that some Members may have additional questions for this panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record. The hearing is adjourned. Thank you all.

[Whereupon, at 4:44 p.m., the hearing was adjourned.]

APPENDIX

October 12, 2011

NAFCU

Testimony of

Gary Grinnell

President/CEO of Corning Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"H.R. 1418: The Small Business Lending Enhancement Act of 2011"

Before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

October 12, 2011

Introduction

Good afternoon, Chairman Capito, Ranking Member Maloney and Members of the Subcommittee. My name is Gary Grinnell and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I appreciate the opportunity to share my views with the committee on H.R. 1418 and credit union member business lending. I have been with Corning Federal Credit Union since 1997, and have served as President/CEO since 2007.

Corning Credit Union was founded in 1936 in Corning, NY in an effort to keep Corning Glass Works employees from being victimized by street-corner lenders. Today, we have over 79,000 members and $896 million in assets. We have 250 employees and 17 branches in New York, Pennsylvania and in the Wilmington, North Carolina area.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of nearly 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding member business lending. We hope you will agree that raising the artificial and outdated job-killing cap on member business lending is overdue and a necessary pro-growth step that will help small businesses and communities recover from the current economic crisis. NAFCU believes H.R. 1418 is about jobs - saving jobs, creating jobs and helping America recover and grow stronger. Who could be opposed to job creation and making our economy stronger? It's time to put aside the tired old arguments of greedy bankers and put jobs, our economy and America first. Today's hearing and the ultimate enactment of H.R. 1418 is an important step in doing just that.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans, including making business loans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for nearly 93 million Americans.

Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While more than 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost, personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation's approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members—while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting de-personalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. While many banks have increased their fees and cut their customer service as of late, credit unions are second to none in providing their members with quality personal service at the lowest possible cost.

Although it is not the subject of this hearing today, I would be remiss if I did not personally thank you Chairman Capito, and all of those who supported the recent efforts to try to bring needed changes to the Durbin debit interchange price-control provision that was added to the *Dodd-Frank Wall Street Reform and Consumer Protection Act*. Like member business lending, this issue is of great importance to credit unions and the consumers they serve, as it will have a direct impact on the ability of credit unions to meet the needs of their membership.

Background on Credit Union Member Business Lending and the Arbitrary Cap

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. In 1998, Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets.

CUMAA also established, by definition, that a business loan of $50,000 and above is a member business loan that counts toward the cap. This number was not indexed and has not been adjusted for inflation in the more than 13 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap in 1998, many of those that meet the needs of small business today, are now included into the cap due to this erosion. To put this in perspective relative to inflation since 1998, what cost $50,000 in 1998 costs $69,500, using the August consumer price index data. That is a 39% rate of inflation change that is completely ignored by current law and which greatly hamstrings a credit union's ability to meet its members' needs.

Also, pursuant to section 203 of CUMAA, Congress mandated that the Treasury Department study the issue of credit unions and member business lending. In January 2001, the Treasury Department released the study, "Credit Union Member Business Lending" and found the following: "...credit union's business lending currently has no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "...relaxation of membership restrictions in the Act should serve to further increase member business lending..." (p. 41).

As stated above, the 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, but that in certain cases, they could be an important source of competition for banks. It is important to note that credit unions have a nominal market share of the total commercial lending universe (approximately 5% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 95% of all small business loans from insured depository institutions) in this environment.

A 2011 study commissioned by the SBA's Office of Advocacy affirms these findings. (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA study also shows, importantly, that credit union business lending has increased in terms of the percentage of their assets both before and during the 2007-2010 financial crisis while banks' has decreased. This demonstrates not only the need for lifting the MBL cap in order to meet credit union members' demand, but also that credit unions continued to meet the capital needs of their business members even during the most difficult of times. One of the findings of the study was that bank business lending was largely unaffected by changes in credit unions' business lending. Additional analysis in the study also found that credit unions' business lending can actually help offset declines in bank business lending during a recession.

Member Business Lending at Corning Credit Union

Corning Federal Credit Union (CCU) currently exceeds 80% of its current cap, and we forecast that we will reach the cap by mid-2012 if Congress does not act. On the business lending side, we have a well diversified portfolio with minimal delinquencies (a delinquency ratio of 0.36%). Our commercial losses have also been minimal as we have an experienced lending staff and a sincere and devoted membership. For the last two years, we have been recognized as the top small community lender by the Small Business Administration in the 34 counties that make up the SBA district in which we are located.

CCU has been an important source of funding for existing, new and growing businesses in the Southern Tier and Finger Lakes region of New York, and the greater Wilmington area of North Carolina since 2006. During the recent economic downturn, as banks in our markets, and particularly in the Wilmington area stopped lending to their clients, CCU has been able to fill an important need to provide these businesses with the funding they need to continue to grow and create jobs.

We started our Business Services program in 2006 in response to demand from our existing membership, and recognition of a gap of such services within our local community. We took a planned and deliberative approach toward starting our program, hiring an outside consultant to help us explore the opportunity and put a detailed, strategic plan together. We have deliberately hired experienced commercial lenders and business services professionals from outside the organization. We have added jobs over the past several years to support our growth and member demand, and now have commercial loan officers, credit analysts, business development officers, supervisors, administrative staff and business account specialists on staff.

There are a number of stories of people we have helped with our business lending program.

A developer in upstate NY turned to us after a local bank that was financing this developer's apartment project tightened up in 2009. The bank pulled back on their original commitment and offered him a much higher rate. They initially financed the entire construction project and at the time of their change in heart, the building was fully occupied. In this situation, the bank took the risk during the construction phase and apparently was not interested in the final project. This developer decided against fighting the change in commitment from the bank, and instead pursued financing elsewhere rather than spending time and money in a lawsuit. CCU was able to refinance the deal and help the developer complete his project and move on to other successful development projects in the upstate NY area, saving critical construction and trades jobs in the process.

A long-time restaurant owner maintained a relationship with an upstate NY bank for decades. He kept all of his business deposits at the bank, and had a commercial mortgage with them. His loan officer at the bank never visited him at any point for years after the loan closed. After years of loyalty to this bank and consistently meeting his loan obligations, he was assessed an arbitrary and onerous transaction service fee on his deposit account, which the bank refused to waive. He decided to move his relationship elsewhere and ended up refinancing the mortgage and moving his entire deposit relationship to CCU.

In 2007, one of our members in upstate NY had a dream of starting up her own pet care business. She worked with the local small business development center to create a comprehensive business plan. She approached a large bank for startup capital, but they had no interest in the loan. Based on a recommendation from another business owner, she approached CCU. Thinking creatively and with the help of the US Small Business Administration, we were able to put together a package of financing to help this member get her dream off the ground. CCU has since assisted her as her business has grown at a rate of 18-20% per year. She has expanded the business with additional services and added half a dozen jobs to the local community.

Mayor Bill Saffo of Wilmington, NC, a port city of over 100,000 residents in one of the fastest-growing regions in North Carolina, turned to us after he received numerous calls to his office from small business owners desperate to obtain financing to keep their doors open and projects on track. The banks, both local and national, have aggressively moved to slash access to credit in this market, in a severe backlash to their risky lending and investment practices prior to the crash. In a move to reduce their own commercial loan portfolios, they have called loans and lines of credit, and forced businesses to pay off their loans early or at renewal regardless of the borrowers' payment history and creditworthiness. The mayor recognized that one of the few financial institutions that bucked this trend is Corning Credit Union. We expanded our presence in the Wilmington market over the past few years, opening two additional branches and hiring experienced people to help develop the business. In numerous instances we have worked with our local business community to provide needed financing which has helped to save and create jobs. Bill Saffo, the mayor of the eighth largest city in North Carolina is a strong proponent of HR 1418. He has directly witnessed how the banks have stripped local businesses of their access to credit while at the same time Corning Credit Union has continued to invest in his community.

We even helped a bank employee in Wilmington, NC, when she couldn't get help from her industry. This member is a commercial lender who works at a community bank in Wilmington. She also owns rental properties in the Wilmington area. After a bank informed her that they would not renew her commercial mortgage after the initial five-year balloon period, she wasn't even able to obtain financing from her employer let alone other banks in the area. She came to CCU, and we were able to refinance her investment property loans for her.

These are just a handful of examples of the people we can help and the jobs we can create with our business lending program. Because we are approaching the cap, we have refrained from advertising or marketing our business services. We have not aggressively pursued additional business to help our communities and support job creation because we have more demand right now than room to lend under our cap. At the current pace of demand that is coming through our doors, we will hit the cap by mid-2012.

In addition, because of our proximity to the cap, and limited ability to grow, we have not hired additional employees recently. If the cap were lifted, we would hire at least two additional employees immediately. We have spent the past six years growing our business lending and business services expertise, infrastructure and support. Given our proximity to our cap, we will need to seriously consider what to do with these highly skilled and well-compensated professionals if we no longer have the ability to actively lend to small businesses. Additionally, we are holding off opening new offices in certain growing markets (where there is demand for commercial loans) because we are running out of capacity under our cap to lend to small businesses. Due to our strong balance sheet we have a significant amount of cash available to lend (almost $300 million) but our hands are tied because of the arbitrary cap. We should emphasize that this $300 million is not taxpayer dollars or government stimulus. It is cash from our depositors that can be used as a source of credit for productive purposes such as helping small businesses in our communities.

We are just reaching the point now (because of our growth and demand) that we are going to have to start turning business away because of the cap. We expect the frequency we will be forced to pass on deals will increase rapidly over the next 6 to 12 months, and those jobs that would be created from those loans may not exist. That is why I am here today to ask for your help to raise this outdated cap. We have the capital, the expertise, and the desire to make a positive impact in our community. Let us help create more jobs.

Myth vs. Reality on MBL

Many in the banking community who oppose the aid to small business that changes to the cap would bring often try to cite safety and soundness issues related to credit unions and business lending. Perhaps the better question would be whether a number of banks should be making commercial business loans. An examination of 2nd quarter 2011 call report data shows that credit unions with MBL's actually have lower business loan losses (0.87% annualized net charge-offs) than commercial lending banks (1.17% annualized net charge-offs). The average size of a credit union member business loan is approximately $222,000, which mitigates credit risk and is evidence that these loans are truly loans to small businesses. Evidence from our members also indicates that many small businesses turn to credit unions after they have been told that the bank does not want their business anymore. It must be noted that despite what some bankers may want you to believe, member business lending is not a new endeavor for credit unions. Credit unions have been making safe and sound member business loans for over 100 years.

The banking industry also argues that the credit union MBL cap should not be raised due to the credit union federal tax exemption. What the banking industry conveniently forgets to mention is that a large number of banks do not pay corporate federal income tax because of their Subchapter S status. There are approximately 2,358 Subchapter S banks that avoid federal income taxes today. What the banking trades don't want you to know, is that one estimated value of the Subchapter S federal tax break for banks is $2.05 billion for 2010, *which is* ***significantly greater*** than the estimated value of the entire credit union tax expenditure ($1.27

billion) for FY2010 as included in the President's FY2012 budget. Perhaps more investigation is needed on the unfair advantage banks have over credit unions due to their Subchapter S federal tax break.

The banking industry also claims that raising the member business lending cap would somehow distract credit unions from serving underserved populations. Here they also forget to mention how they have sued the National Credit Union Administration in the past as part of an effort to prevent credit unions from reaching out to serve more underserved areas. Credit unions have a long history of demonstrated service to underserved communities and outperforming banks as evidenced by historical Home Mortgage Disclosure Act (HMDA) data. Creating jobs is one of the most important ways to help underserved communities in these tough economic times. Raising this arbitrary, job-killing member business lending cap will help create these much needed jobs.

Some critics claim that only a limited percentage of credit unions are actually at the arbitrary member business lending cap and therefore nothing needs to be done. This view fails to see the big picture of how the arbitrary cap acts as a deterrent for efforts to increase business lending and create American jobs. Successful business lending programs like ours at Corning Credit Union require investment in human and other resources by the institution. Those credit unions that have some member business lending but are not near the cap, have an artificial disincentive in the arbitrary cap. Nearly 2,200 credit unions make member business loans. If they are successful in growing and expanding their business lending program, they will ultimately reach this arbitrary barrier forcing them to scale down what they invested in to build up. Furthermore, a number of credit unions are discouraged from establishing member business lending programs, as the cap creates artificial limits to their potential for lending, potentially skewing the cost-benefit analysis of investing in a member business lending program and discouraging them from getting involved at all.

One final point must be made in response to the argument that only a few hundred credit unions are near the cap would directly benefit from raising the cap. The concept of helping only a limited number of institutions did not stop Congress from making $30 billion in taxpayer dollars available to community banks last year under the Small Business Lending Fund. Only a few hundred community banks have taken taxpayer money under that program, a significant number of which did not even use it for business lending. H.R. 1418 has a lot less cost and a lot more benefit than that well-intentioned, but unsuccessful effort.

At Corning Credit Union, we started our business lending program in 2006 and our successful, managed growth has us already approaching the cap today. As we approach the cap, we have actually had to scale back promoting our business lending program to those who may need credit, as the artificial cap is crimping the ability for us to meet the existing demand of our membership. If this artificial cap were raised, we could create more jobs internally and help small businesses create more jobs in our community.

H.R. 1418, the *Small Business Lending Enhancement Act*

In April of 2011, Representatives Ed Royce and Carolyn McCarthy introduced the *Small Business Lending Enhancement Act* (H.R. 1418), which would raise the arbitrary credit union member business lending cap to 27.5 % of total assets, up from 12.25%, and help stimulate the nation's struggling economy by increasing access to credit for small business owners. This important legislation has over 85 bipartisan co-sponsors. Identical bipartisan legislation (S. 509) has been introduced in the Senate.

The *Small Business Lending Enhancement Act* is a well thought out solution that includes important provisions to ensure that safety and soundness concerns are addressed. This bill is not about helping credit unions - it is about helping small businesses create jobs.

In order to see its cap increased, a credit union would need to meet strict eligibility requirements to gradually increase its member business lending portfolio, including: being well capitalized [currently at least a 7% net worth ratio]; having at least 5 years of member business lending experience; must be at or above 80% of the current 12.25% cap for at least 1 year before applying; and, must be able to demonstrate sound underwriting and servicing based on historical performance and strong management. The requirements in this legislation mirror those endorsed last year by Treasury Secretary Timothy Geithner and NCUA Chairman Debbie Matz.

As evidenced by the strict eligibility requirements outlined above, the *Small Business Lending Enhancement Act* was specifically tailored to address concerns that raising the current cap could somehow create safety and soundness issues.

Unlike efforts enacted by Congress to provide $30 billion to promote business lending at community banks, credit unions don't need to take taxpayer dollars to make worthwhile loans. While similar legislation to H.R. 1418 scored at a cost of $77 million over 5 years according to a 2010 CBO estimate, it should be noted that this cost does not take into account added tax revenue that would be gained from the businesses and jobs created by enacting this legislation. This pales in comparison to the price tag for what Congress did for the community banks in the last Congress when the *Small Business Jobs Act* created a $30 billion "Small Business Lending Fund" (SBLF) with the intention of encouraging community banks to lend to small businesses. To date the program has created very few if any jobs, and has done little to spur economic growth for its $30 billion price tag. Furthermore, it has been reported that only about 332 banks received funding under the $30 billion program. An October 6th *Wall Street Journal* article entitled "Tale of Two Loan Funds" described how nearly 40% of those who took funds used them to pay off TARP obligations, instead of making needed loans to America's small businesses. In the article, one community banker even admitted "It's a bit of a shell game." Furthermore, this same article noted that banks denied up to 60% of small business loan applications this year. Clearly this is something Congress should investigate further. Credit unions don't think creating jobs for the American economy is a game and we don't need taxpayer funds to do it. It is a serious business, and we stand ready for the task.

Failing to consider legislation to raise the arbitrary member business lending cap last Congress was a missed opportunity to further assist small businesses create jobs and help move the economy in a positive direction. NAFCU and its member credit unions ask that the *Small*

Business Lending Enhancement Act be considered by the Financial Services Committee and on the House floor as soon as possible.

Industry estimates that enacting H.R. 1418 could help spur over $13 billion in new lending and create over 140,000 new jobs in the first year alone. In an environment, where job creation is so important, it is unfathomable to the nation's 93 million credit union members that Congress would not move forward with such a bipartisan commonsense approach that has no sound policy argument against it, only misguided opposition from the banking industry.

We understand that community banks are seeking their own forms of relief as part of the *Communities First Act*, H.R. 1697. One approach to provide fair relief to all would be to combine both bills and pass as a package. While this may not be the first choice for banks and credit unions, it may be a fair compromise to aiding our nation's community institutions and putting job creation first. Failure to consider raising the member business lending cap for credit unions, while at the same time advancing H.R. 1697 and its provisions, would likely lead to public opposition from NAFCU and the entire credit union community, its members, and small businesses.

Credit unions have been vital in helping our country recover from the financial crisis, and members of Congress on both sides of the aisle recognize that they were not the cause of it. Many credit unions have capital to lend small businesses across the country and are in a position to further assist in recovery efforts and help create jobs. However, due to the outdated and arbitrary member business lending cap, their ability to help stimulate the economy by providing credit to small businesses is hampered. Removing or modifying the outdated and arbitrary, job-killing credit union member business lending cap would provide needed economic stimulus at no cost to taxpayers and no increase to the federal deficit. Credit Unions have their own capital and liquidity ready to invest in their communities and help their members. Enacting H.R. 1418 will free up those funds to help create American jobs.

Conclusion

The artificial credit union member business lending cap established in 1998 is arbitrary and outdated. In short, it is killing thousands of potential jobs in the economy. The need for such a cap was questioned by the Treasury Department as far back as 2001. Credit union member business lending is not a threat to the banking industry which currently controls nearly 95% of all small business lending at insured depository institutions. While NAFCU believes that no statutory cap should be in place, a number of credit unions like mine, and the millions of members we serve, would benefit from the enactment of H.R. 1418, the *Small Business Lending Enhancement Act*. This legislation would provide a practical and well-thought out approach to raising the arbitrary threshold, while addressing concerns about rapid growth and safety and soundness. This is a real bipartisan jobs package that everybody should be able to support.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's economy. I would welcome any questions that you may have.

MASSACHUSETTS CREDIT UNION
MSIC
INSURED SAVINGS
SHARE INSURANCE CORPORATION

H.R. 1418: The Small Business Lending Enhancement Act of 2011

Testimony of

Michael C. Hanson

President and Chief Executive Officer

Massachusetts Credit Union Share Insurance Corporation (MSIC)

Westborough, Massachusetts

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

October 12, 2011

H.R. 1418: The Small Business Lending Enhancement Act of 2011
Testimony of Michael C. Hanson
October 12, 2011

Chairman Capito, Ranking Member Maloney and Members of the Committee, thank you for holding this hearing on *H.R. 1418: The Small Business Lending Enhancement Act of 2011.*

My name is Michael Hanson, and I serve as President and CEO of the Massachusetts Credit Union Share Insurance Corporation, commonly referred to as MSIC.

MSIC is the nation's oldest insurer of credit union deposits; it was formed by an act of the Massachusetts Legislature in 1961, to effect a public policy that all credit union members in Massachusetts have their deposits *fully* insured. This year, MSIC is celebrating its 50th Anniversary and continues its history of providing safe and secure deposit insurance to Massachusetts consumers, in good times and bad.

Today, MSIC is an excess insurer, providing deposit insurance for amounts in excess of the coverage provided by the National Credit Union Share Insurance Fund (NCUSIF). MSIC insures 97 credit unions operating in Massachusetts (both state and federally chartered). Those institutions hold approximately $18 billion in assets and serve 1.6 million consumers.

MSIC has also served as the receiver for credit unions for the Massachusetts Commissioner of Banks, and we provide technical, capital, management and training assistance to our member credit unions. MSIC is a not-for-profit cooperative corporation, and runs an insurance fund which has been contributed to over the years by member credit unions. MSIC's excess insurance is backed by the fund as well as by each of our 97 member credit unions. We are a true cooperative, and MSIC is not sponsored or funded by any governmental entity.

In managing MSIC's insurance risk, we have a substantial monitoring program which evaluates the health and safety of both MSIC member credit unions in Massachusetts and the condition of the industry nationwide. Our independent evaluation of the condition of the credit union industry is the basis for my testimony today.

My own background has been submitted with my written testimony, but I would like to highlight one aspect that is relevant today. During 1991 and 1992, I served as the Massachusetts Commissioner of Banks, during the height of the New England Banking crisis. As a result, I have substantial experience in evaluating and supervising financial institutions, including both banks and credit unions, under adverse conditions.

H.R. 1418 is sound public policy and I urge its timely adoption.

In reaching this position, I have considered the following:

- The nation's economy is in need of added small business lending in order to stabilize our economy, to ease the unemployment crisis, and to provide a foundation for future economic growth.

- H.R. 1418 will allow the redeployment of existing credit union capital to member business lending, thereby increasing the amount of available lending to this important economic segment.

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- This action will not require any financial contribution by the federal government.

- Out of the nation's 7,386 credit unions, only 2,096 institutions engage in member business lending. Below is a break down for each credit union asset size category (data as of June 30, 2011):

Data as of 06/30/2011	**>$500M**	**$100M - $500M**	**$50M - $100M**	**$10M - $50M**	**<$10M**	**Total Nation-Wide CUs**
Total Assets	$600,935,470,098	$226,660,241,084	$56,343,805,911	$58,620,829,256	$12,197,730,538	$954,758,076,887
Total Loans	$370,233,036,595	$134,663,062,221	$31,096,491,116	$29,738,600,307	$5,768,166,570	$571,499,356,809
Total MBL	$23,441,304,830	$7,353,754,691	$883,465,084	$598,758,423	$27,390,020	$32,304,673,048
% of MBL to Assets	3.90%	3.24%	1.57%	1.02%	0.22%	3.38%
% of MBL to Loans	6.33%	5.46%	2.84%	2.01%	0.47%	5.65%

Source: NCUA; Calculations by MSIC.

- Member business lending continues to increase, and has become an important component of credit union loan portfolios. Nation-wide as of June 30, 2011, data for credit unions indicate total member business loans increased 5.57% to $32.3 billion, as compared to $30.6 billion the same time last year. This represents 5.65% of the total credit union loan portfolios.

- The history of credit union member business lending since the imposition of the current cap, set by the adoption of the *Credit Union Membership Access Act* (P.L. 105-219) in 1998, demonstrates clearly that those institutions participating in member business lending have done so in a safe and sound manner, and have the necessary infrastructure and expertise to continue to do so with added legal capacity. For example, current delinquency and charge off rates for member business lending is very reasonable for this type of lending in the current economic environment, and is no worse than the current numbers for the banking community. Delinquency at mid-year 2011 dropped to 3.64%, which is a 52 basis point improvement from the same time last year. Net charge-offs increased 18 basis points to 0.91% during the first half of 2011 compared to 0.73% in the same period last year. This compares to delinquency and net charge-offs for all credit union loans of 1.58% and 0.95%, respectively, for the first half of 2011.

- Credit Unions have only a small share of this national market, and should pose no competitive threat to the banking industry, even with the increased limit provided by H.R. 1418. In any event, increased competition is good for both industries, and more importantly, for consumers and the nation.

- We believe H.R. 1418 will give necessary tools to the credit union industry to succeed and prosper in the coming years, and will therefore improve the insurance risk to the NCUSIF, and, to a far smaller extent, upon MSIC's insurance risk. A prosperous credit union industry is good for consumer lending as well as the delivery of financial services to persons of modest means and the underserved.

- Credit Unions did not participate in the consumer predatory practices that occurred during the recent financial crisis, as they consider their customers members and owners of their institutions. They have not engaged in such practices in any form of lending and will continue to provide consumer friendly products and services under H.R. 1418.

- H.R. 1418 provides more than sufficient safeguards on the expansion of credit union member business lending, and the National Credit Union Administration has, and will continue to, adequately supervise this area of business.

- We believe that the additional small business lending authorized by H.R. 1418 will help create jobs in the broader economy as demand increases.

Conclusion

The member business lending cap established in 1998 is now outdated. H.R. 1418 provides a sound framework for the expansion of this important activity, will provide some small measure of relief in the broader economy at no cost to the government, and will give important tools to the credit union industry for its future prosperity. Consumers will benefit as a result. I urge adoption of H.R. 1418.

Thank you for your attention and the opportunity to present my views. I would be happy to answer any questions.

Testimony of

Albert C. Kelly, Jr.

On behalf of the

American Bankers Association

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

United States House of Representatives

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October 12, 2011

Chairman Capito, Ranking Member Maloney, and members of the Subcommittee, my name is Albert C. Kelly, Jr., Chairman and Chief Executive Officer, SpiritBank, a $1.3 billion bank headquartered in Bristow, Oklahoma. I am also the chairman-elect of the American Bankers Association. ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees.

ABA is strongly opposed to recent efforts by the credit union industry to redefine the credit union charter in ways that would effectively turn credit unions into tax-exempt banks. This effort, most recently embodied in H.R. 1418, the "Small Business Lending Enhancement Act of 2011," would allow the NCUA to permit credit unions that are within 80 percent of their member business lending (MBL) cap to increase this cap to 27.5 percent of assets – ***more than double the current cap, and greater business lending authority than that of federal thrifts.***

Under H.R. 1418, credit unions would be allowed to further leverage their tax advantage and compete even more with tax-paying banks. The result of this competition would not be an overall increase in lending. Rather, an increase in the business loan cap would cause some business loans that are currently being made by taxable financial institutions to be shifted to credit unions. Shifting loans in this manner would result in less taxes being paid by banks, leading to an increase in the federal deficit at the very time Congress is looking for ways to reduce it. In fact, the Congressional Budget Office (CBO) in 2010 scored a bill that would raise the credit union business lending cap ***as an increase to the deficit of $354 million over 10 years relative to the CBO baseline***.

Credit unions already have ample lending authority to make small business loans. ***Business loans under $50,000 do not count against the current cap of 12.25 percent***, nor do many other types of business loans. These exemptions mean that credit unions have ***unlimited*** business lending for small loans already, without the need to seek increases in their MBL limits.

In fact, only a few credit unions – ***96 out of 7,292 credit unions*** – are within 80 percent of their cap, as of year-end 2010.

There is a strong legislative history that supports the unique charter of credit unions ***with very specific restrictions on business lending***. The restrictions were put in place to ensure that credit unions remained primarily focused on individuals – people of modest means. By offering an expanded business lending cap only to credit unions that are already close to their limit, H.R. 1418 ***would serve as an invitation to credit unions that are not near this cap now to focus on business lending – rather than consumer lending*** – in order to be eligible for an increase in their business lending cap. Clearly, this behavior does not encourage a focus on credit unions' central mission.

The restrictions on business lending were also put in place to protect credit unions from lending that could pose serious threats to safety and soundness. The congressional concern that led to these restrictions is well-founded and echoed by many within the credit union industry itself. ***Business lending is risky business, and should be limited for all credit unions***. In fact, according to a report from NCUA on the costliest credit union failures, business lending was found to be a major contributor to failure in 7 of the 10 costliest failures.

Instead of trying to broaden tax-advantaged lending, increasing the deficit in the process, credit unions that seek to expand business lending opportunities can reach out with credit in their communities through a method that is already available – ***by converting to a mutual savings bank charter***. This charter provides the flexibility credit unions desire and preserves the mutual-member focus that is the trademark of the credit union charter. ***It would put these credit unions on equal footing with banks,*** with respect to taxes and regulatory oversight. However, rather than encourage the natural evolution to mainstream banking, ***NCUA actively impedes the conversion process.*** Removal of NCUA's obstructionism would be a far better alternative to enable more business lending.

There are four key points I would like to make today:

- Raising the credit union legal business lending cap is ***not necessary*** for credit unions to meet small business members' credit needs.
- Business lending is riskier and ***raises serious safety and soundness concerns***.

- Expanding the lending cap is ***inconsistent with the credit union mission*** of serving consumers, especially those of modest means, and ***would increase the federal deficit.***
- There is a better option for credit unions that want to expand business lending – ***convert to a mutual bank charter.***

I. Raising the credit union legal business lending cap is not necessary for credit unions to meet small business members' credit needs

Credit unions argue that greater business lending authority would enable them to meet the needs of small businesses seeking credit. Such arguments are simply not true. Under current law, ***business loans under $50,000 do not count against the aggregate business loan cap*** of 12.25 percent of assets.

Let me state this more clearly. ***Credit unions can already make all the business loans they want under $50,000.*** Credit unions begin with a blank slate when they make further business loans over $50,000.

Moreover, the guaranteed portion of Small Business Administration loans does ***not*** count against the aggregate business loan limit, ***nor*** do loans secured by 1 to 4 family primary residences. In addition, NCUA has aggressively provided exclusions from the cap by regulatory fiat. For example, in October 2003, NCUA excluded business loans made to nonmembers from the cap, allowing more loans by credit unions to circumvent the aggregate business loan cap. As of March 2011, credit unions reported extending almost $6.7 billion in non-member business loans, which account for almost 18 percent of all outstanding credit union business loan balances. This represents a three-fold increase in nonmember business loans on the books of credit unions in 6 years.

Clearly, there is considerable opportunity under current law for credit unions to meet the needs of small business customers. Furthermore, only a few credit unions – ***96 out of 7,292 credit unions*** -- are within 80 percent of their congressionally-mandated cap of 12.25 percent of assets, as of year-end 2010, and could be affected by H.R. 1418. This was acknowledged by

NCUA Chairman Deborah Matz last year in a hearing: "It's a small number that are at their cap."[1]

The minority who are at or near this cap are a new breed of institution that bears little resemblance to traditional credit unions. These "morphed" credit unions, which seek out large commercial customers, are a far cry from traditional credit unions, which have remained true to their credit union mandate to serve people of small means.

II. Business lending is risky and raises serious safety and soundness concerns

Lifting the business lending cap and allowing more large business loans also raises serious safety and soundness concerns. As credit unions have aggressively pursued business lending options, business loan delinquencies have risen and some credit unions have failed. Even other credit unions are concerned about the impact that increased business lending will have on the credit union industry as a whole. Dale Kerslake, President and CEO of Cascade Federal Credit Union (Kent, WA) wrote:

> Doubling [member business lending (MBL)] limits for natural person credit unions is not something a majority of credit unions want or need. Yet, if a minority of powerful credit unions and industry trade associations get their way, which they usually do, MBL could easily become the next industry crisis… The proposed MBL limit increase … lacks safeguards for the thousands of credit unions that pay into NCUSIF and do not do business lending.[2]

Ron Burniske echoed these comments, after his credit union, Chartway Federal Credit Union (Virginia Beach, VA) took over a failed Utah credit union:

> We shouldn't be doing strip centers, corporate buildings and land development. That's not who we are. That's the banks' business.[3]

Credit unions have good reasons to be concerned. As of June 2011, 3.64 percent of all credit union business loans were at least 60 days or more past due. An additional $2.2 billion in

[1] Senate Committee on Banking, Housing, and Urban Affairs. "State of the Credit Union Industry" December 9, 2010.
[2] "MBL Limits – Be Watchful of What Others Wish For," Credit Union Times, February 10, 2010.
[3] "1 deal down, at least 1 to go for Chartway," Inside Business, January 11, 2010.

business loans have been modified. As a concrete example, America First FCU (Riverdale, UT) recently reported that $148.3 million of its $430 million of member business loans were 12 months or more past due – 34.5 percent. The average size of a delinquent business loan at America First is $2.2 million, hardly a small business loan. Moreover, 72 percent of its delinquent loans have been past due for 12 months or more. If America First were regulated by bank regulators, these loans would have been charged off.

In December 9, 2010 testimony, NCUA Chairman Debbie Matz stated: "Presently, 270 of the 633 credit unions which have a 3, 4, or 5 CAMEL rating and make member business loans, MBLs are the primary or secondary contributing factor for the supervisory concern." ***This means that approximately 30 percent of all credit unions that make business loans were a supervisory concern.***

Here are some examples of large business loans that have gone bad:

- Centris FCU (Omaha, NE) held ***$11 million*** in bad loans to Great Adventures Water Resort.
- Denali Alaskan FCU filed suit against a prominent real estate developer over ***$17 million*** in delinquent loans.
- Telesis Credit Union (Chatsworth, CA) was foreclosing on a ***$3 million loan*** on a mixed-use office building in Memphis, Tennessee.[4]

In fact, on November 23, 2010, the NCUA's Office of the Inspector General released a report summarizing the 10 costliest natural person credit union failures. ***In 7 of these 10 failures, business lending was a major contributor to the failure.***[5]

Since the report was issued, NCUA also placed $1.6 billion Texans Credit Union into conservatorship. The credit union, starting in 2003, grew its commercial real estate loan portfolio very rapidly to almost $800 million by 2007. It funded projects ***hundreds of miles away:*** a mall project in Illinois, a luxury condo development in Telluride, Colorado, and subdivisions in Mississippi.[6] Eventually, some of these commercial real estate projects failed. This action arose from faulty lending on commercial real estate projects – some of which were outside of its market area.

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[4] "Telesis' Loan Recoup Attempts Go On," Credit Union Times, December 15, 2010.
[5] Appendix A provides more details about what the Inspector General discovered.
[6] "The Rise and Fall of Texans Credit Union," Dallas Morning News, May 8, 2011, p. D1.

Last month, NCUA placed Chetco FCU of Harbor, Oregon into conservatorship because of problem business loans. As of June, the $333 million credit union had ***over half of its assets in business loans***.

The General Accountability Office in 2003 warned about the danger of business lending by credit unions and it was skeptical that NCUA was up to the challenge to monitor the expansion of credit union business lending.[7] It should come as no surprise that the Inspector General's Material Loss Review[8] found adequate oversight often missing: business loans were made to non-members; credit unions exceeded the legal Member Business Loan cap of 12.25 percent; credit unions violated the loan-to-one borrower limit; and credit unions made business loans without a Member Business Loan policy. ***Expanding credit union business lending only encourages larger, riskier loans, without any assurance of adequate oversight.***

In addition, NCUA in 2003 authorized credit union service organizations (CUSOs) to originate business loans as a permissible power, even though these third party vendors are ***not*** subject to NCUA supervision. Today, many credit unions hold business loans that were originated by these credit union service organizations. For example, CU Business Group reported in 2009 that it has underwritten over $2 billion in business loans since its inception in 2002. Michigan Business Connection, a CUSO supporting more than two dozen credit unions, reported managing a portfolio of over $200 million. Cooperative Business Services, LLC, a CUSO owned by nine Ohio credit unions, reported on its website that it recently provided funding for a $3.56 million investment property.

Unfortunately, loans originated by CUSOs have resulted in credit union failures. Credit Union Times quotes NCUA Board Member Gigi Hyland addressing the National Association of Credit Union Service Organizations earlier this year regarding losses at Texans CU arising from its business lending CUSO as saying: "We could see things were going wrong but we had to go through the side door and through the maze to get there. By the time we got there, it was too late."[9]

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[7] Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management. U.S. General Accounting Office, October 2003 (GAO-04-91), p. 49.
[8] http://www.ncua.gov/Resources/OIG/Files/Reports/2010/OIG-10-20OIGCappingReportMLRs_11.23.10.pdf
[9] "NCUA Sells Importance of Increased CUSO Authority to Stay Ahead of Losses," Credit Union Times, May 4, 2011.

III. Expanding the business lending cap is inconsistent with the credit union mission of serving consumers and would increase the federal deficit

The real goal of expanded business lending is for some aggressive credit unions to make even more large dollar loans. The truth is that these new-breed credit unions have made business lending a top priority as they seek to rapidly grow the institution – making loans that any taxpaying financial institution would want to make. In fact, when seeking market share, some credit unions make loans that no insured depository should make. The fact that a few credit unions are hitting the Congressionally-mandated limits on business lending is largely because they are making large commercial loans – including those to businesses out of their market area.

This business lending is coming at the expense of consumer lending, and ***H.R. 1418 does nothing to protect members' interests with regard to consumer loans.*** In other circumstances where a credit union seeks to switch to a mutual savings bank charter, NCUA requires "a clear and conspicuous disclosure" that this may reduce consumer loans.[10] Ironically, the bill ***does not require*** the credit union to notify members in a clear and conspicuous manner that they could see a reduction in consumer loans. And the bill ***does not require*** the members of a credit union to approve in the affirmative an expansion in business lending, an action that would essentially create a tax exempt bank. Credit unions that seek a mutual savings bank charter must both mail such a disclosure to their members ***and*** have an affirmative vote.

A dramatic example of just how far credit unions have strayed from their mission is the financing of Thumper Pond, a resort development in Minnesota that went bankrupt. This luxury resort featured a golf course, spa, water park, hotels, and a planned condominium community. The resort was financed by a large commercial loan made by Spire Federal Credit Union and is clearly counter to the chartered mission of serving people of modest means. Moreover, the resort is located over 200 miles from the credit union's headquarters. Is this the kind of loan that should be tax-subsidized?

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[10] NCUA's own regulations governing the conversion of a credit union to a mutual savings bank have greater protection of members' interests regarding consumer loans than H.R. 1418. NCUA regulations require "... a clear and conspicuous disclosure of how the conversion from a credit union to a mutual savings bank will affect the institution's ability to make non-housing-related consumer loans because of a mutual savings bank's obligations to satisfy certain lending requirements as a mutual savings bank."

Cases like the Thumper Pond fiasco show that credit unions are leveraging their tax-exemption to provide loans to large businesses that already have plenty of credit options available through taxpaying banks. Make no mistake about it, H.R. 1418 ***is nothing less than legislation that would allow a credit union to look and act just like a bank, without the obligation to pay taxes or have bank-like regulatory requirements, such as the Community Reinvestment Act, applied to them.*** Provisions included in H.R. 1418 that try to safeguard this high-risk form of lending are not the issue; rather, the issue is that credit unions have a limited charter, focused on people of small means, for which credit unions have a tax exemption.

This credit union tax expenditure takes revenue from banks that compete for these same loans – revenue that would be taxed and would help to offset some of the current federal budget deficit.

Congress put these current limits in place after considerable debate to ensure credit unions remained focused on individuals, especially people of small means. In fact, the Senate Report implementing the Credit Union Membership Access Act of 1998 stated that the limits "...are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, through the emphasis on consumer rather than business loans."[11]

IV. There is a better option for credit unions that want to expand business lending – convert to a mutual bank charter.

While credit union rhetoric suggests that without greater business lending authority there are no options for these institutions to grow and better serve their customers, the reality is that a very viable option is available today through switching to a mutual savings bank charter – a route that some credit unions have already taken and three other credit unions are pursuing. This charter provides greater flexibility, still preserves the mutual-member focus that credit unions find desirable, and is accompanied by the effective and experienced supervision of traditional banking regulators.

For example, in 2009, Coastway Credit Union in Cranston, RI converted to a mutual savings bank so that it could make more business loans. Viewpoint Bank, which converted from

[11] Senate Report 105-193, May 21, 1998, pp.9-10.

a credit union to a mutual savings bank in 2005, has taken advantage of its greater business lending authority – almost 18 percent of its assets are in business loans.

The savings bank charter gives credit unions the ability to expand their business lending and retain their mutual structure. However, NCUA actively impedes the ability of credit unions to engage in charter choice. Removal of NCUA's obstructionism is a far better alternative to enabling more business lending than a wholesale change in powers that will benefit only a small proportion of large, tax-exempt credit unions. Facilitating conversion to a mutual savings bank charter will benefit those credit unions that have outgrown their charter, and will also improve the fiscal position of the United States as these entities pay their fair share of taxes.

Conclusion

Increased business lending powers are not necessary to meet the credit needs of businesses. Credit unions have ample authority under current law to make all the small business loans they want. H.R. 1418 would empower credit unions to make larger commercial loans and cause credit unions to stray even further from their mission to serve consumers, especially those of modest means. Increasing the business lending cap will raise serious safety and soundness concerns, and it will cause an increase to the federal deficit.

Rather than expanding the business lending authority of credit unions, Congress should close the loopholes that are allowing credit unions to make business loans to non-members to circumvent the aggregate business loan cap. Additionally, Congress should rightfully be concerned about the increasing use of third-party vendors by credit unions to originate business loans, as CUSOs are a ticking time bomb waiting to explode given the fact that NCUA does not have authority to regulate these entities.

In the current situation where non-traditional credit unions forsake the common bond in favor of fast growth, and where energies are diverted to favoring the well-off and businesses rather than meeting their chartered obligation to serve people of modest means, it is no surprise that ABA opposes expansion of credit union powers. To allow such expansion will only move the new breed of credit unions further and further away from their mandated mission.

Appendix A

Business Lending Helped Lead to Credit Union Failures

The NCUA Office of Inspector General's Capping Report on Material Loss Reviews (MLR) found that the concentration of Member Business Lending (MBL) was a frequent area of concern. Of the ten MLRs that were reviewed for the report, the MBL issue was a factor in seven of the credit union failures. The table below explains each credit union's MBL problem.

Credit Union	MLR Issue: Member Business Lending
Huron River Area CU	Management violated NCUA's MBL limits by failing to limit its aggregate net MBL balance to the lesser of 1.75 times its net worth or 12.25 percent of its total assets. Based on Huron's December 2006 net worth and total assets of approximately $41 million and $363 million, respectively, Huron's MBL balance should not have exceeded approximately $44 million. As of February 2007, NCUA determined Huron had approximately $187 million worth of MBLs in its Florida construction loan portfolio, an amount over four times the statutory limit.
Norlarco CU	Management allowed some borrowers to own multiple properties - some on the same street, which were not reported as member business loans. By December 2006, the credit union's MBL balance was approximately $39 million, or 1.15 times its net worth and 10.9 percent of its total assets, which was within NCUA's statutory limits. After reclassifying the loans, the MBL balance increased to $86.7 million, nearly three times it's net worth and double its statutory limits. The credit union's ratio of MBLs to assets was more than 24 percent. Although examiners did not have accurate information regarding the credit union's MBL balance because of misclassified MBLs, examiners failed to recognize the borrower's intent was often misrepresented on the loan applications underwritten by the credit union's third-party provider, First American. In fact, not until the credit union was placed in NCUA's Special Actions did NCUA officials learn that management's internal controls over the RCL program were so lax that the Board and management failed to recognize the vast majority of the loans in the RCL portfolio were for investment purposes. Additionally, officials in Special Actions determined some borrowers owned multiple properties - some on the same street, which were not being reported as member business loans (MBLs). As a result, NCUA Special Actions required management to reclassify every construction loan as a MBL until each borrower could be contacted to verify the intent of their loan.
High Desert FCU	Management did not have an adequate MBL policy, particularly related to equity requirements and lack of proper recordkeeping to monitor compliance with an MBL waiver issued in August 2003, and ensuring income verification for MBL borrowers. Although examiners identified the credit union's MBL issues such as underwriting and permissible MBLs through DORs in every examination from 2003 through 2008, examiners did not draw management's attention to the fact that the credit union's DOR issues were repeat issues that should have been addressed more timely.
Eastern Florida Financial CU	Management violated numerous MBL regulatory limits. Also, MBL underwriting was not robust. Approximately $51 million of the MBL balances remained on the credit union's delinquency report for the first three Call Report cycles in 2008. One of the larger MBLs in delinquent status was not properly classified in the credit union's Call Report resulting in an understated delinquent loan ratio. Examiners needed earlier and stronger supervisory action, which may have influenced the credit union's Board and management to limit the significant level of risk assumed during the institution's rapid growth period, especially in their CDO leverage strategy and MBL activities, where they suffered the largest losses that caused the failure.
Clearstar FCU	Management continued to make MBLs despite being undercapitalized, a violation of NCUA Rules and Regulations.
Ensign FCU	Management violated NCUA Rules and Regulations over member MBL limitations for construction and development loans, MBLs to one individual or associated group, and aggregate MBLs, respectively. All repeat violations from a prior examination.
St. Paul Croatian FCU	Management had no MBL policies in place despite having MBLs in the portfolio.

Source: NCUA OIG Capping Report on MLRs, 10/20/10

ICBA
INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Testimony of

Salvatore Marranca
Director, President, and CEO
Cattaraugus County Bank

On behalf of the

Independent Community Bankers of America

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"H.R. 1418: The Small Business Lending Enhancement Act of 2011"

October 12, 2011
Washington, D.C.

Opening

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, I am Sal Marranca, Director, President, and CEO of Cattaraugus County Bank, a $174 million asset bank in Little Valley, NY. I am also Chairman of the Independent Community Bankers of America and I am pleased to be here to represent our nearly 5,000 members nationwide at this important hearing on credit union member business lending.

ICBA appreciates this opportunity to testify on legislation (H.R. 1418) that would expand credit union powers by raising the cap on member business loans as a percentage of assets. We strongly oppose H.R. 1418. Congress should not expand credit union business lending powers unless it is also prepared to tax credit unions and require them to comply with the Community Reinvestment Act. The credit union tax exemption is directly linked to and can only be justified by their original mission of serving individuals of modest means. Any expansion of their powers beyond the original mission should result in the loss of their tax exemption.

I want to make clear that community bankers strongly support locally-based non-profit organizations. These non-profits justify their tax exemption by serving a public mission. Our concern is that credit unions, having strayed far from their statutory mission, are abusing their tax-exempt status and are seeking to go even farther. Simply stated, credit unions are tax-exempt for a reason and were never meant to be commercial lenders. If they want to break from their tax-exempt purpose then they must pay taxes. That is the only just, logical and fair tax policy.

This topic is not in the least abstract for me. For my bank, credit union business lending represents an immediate threat. I'm happy to compete with other tax-paying lenders, even large banks, but the credit union tax exemption creates an unfair advantage and distorts the market.

H.R. 1418 would allow the NCUA to approve member business loans that raise a credit union's total amount of outstanding loans to 27.5 percent of assets – more than double the current cap of 12.25 percent. The current cap was established in 1998 as part of the Credit Union Membership Access Act, which completely undermined the original "common bond" requirement for credit union customers. In 1998 the Supreme Court ruled that a credit union could not serve a customer base with multiple common bonds. Six months later, Congress reversed the Supreme Court decision, thereby allowing for multiple bond membership. Because the law made the common bond requirement nearly meaningless, the member business lending cap was deemed especially important to maintain a distinction between tax-exempt credit unions and taxpaying banks. The 12.25 percent cap was not chosen arbitrarily but was intended to ensure that commercial lending would comprise no more than a marginal part of a credit union's lending.

The credit unions have portrayed H.R. 1418 as an effort to make more credit available for small businesses. The truth is that only a small number of credit unions are at or near the current member business lending cap – only 162 of the approximately 7,300 credit unions, or just over 2 percent, according to the NCUA. Notably, more than 70 percent of credit unions report no member business loans at all. Those credit unions that are at or near the cap are the largest and most complex credit unions, and the business loans they make are often multi-million dollar, speculative, commercial loans – not small business loans. There is ample capacity for the remaining 98 percent of credit unions to expand their member business lending. The fact that only 4.5 percent of credit union assets are invested in commercial loans – a figure cited by advocates of H.R. 1418 – does not suggest that the current cap of 12.25 percent is too low. What's more, because there are numerous exceptions to the member business lending cap, the cap does not prevent robust credit union business lending. These exceptions are:

- Any loan of less than $50,000;
- Small Business Administration loans, including 7(a) and 504 SBA business loans of up to $5 million;
- Non-member loans and loan participations purchased from other credit unions;
- Loans made by any credit union grandfathered by the 1998 law because they had a history of making business loans or were chartered for the purpose of making business loans;
- Loans made by low income or community development financial institutions; and
- Loans secured by the borrower's primary residence.

With regard to this last exception, I note that some of the examples of supposed commercial credit union loans cited by advocates of H.R. 1418 are actually loans secured by the borrower's residential mortgage, which are not subject to the cap. These loans are not small business loans based on the lender's understanding of the business's cash flow, debt coverage, and other factors that go into commercial credit underwriting. Rather, they are second mortgages based on the home's value as collateral should the business fail -- a type of lending that is aggressive and risky at best.

H.R. 1418 is not driven by the need to bring credit to small businesses. It would not expand credit, but would merely reallocate loans that would have been made by tax-paying banks to tax-exempt credit unions. H.R. 1418 is driven by a small number of credit unions who want to increase their assets and their revenues while still enjoying their tax-exempt status. In this process, federal, state and local revenues would shrink further because tax-exempt credit union lending would displace that of taxpaying providers.

Credit Unions Lack Expertise in Commercial Lending

What's more, commercial lending is not for novices. It takes many years of experience and a firm grasp of the commercial environment to properly evaluate a business loan application, to value the collateral, and to understand the risk and price accordingly. Credit unions lack the experience and the expertise to safely conduct commercial lending, and their regulator, the NCUA, lacks experience in supervising commercial lending. In fact, the failure of large credit unions in recent years was directly tied to their aggressive ventures into commercial lending. The fallout was costly for the entire sector, including many credit unions that never strayed into commercial business lending. Maybe that is why H.R. 1418 adds provisions that are intended to ensure that credit unions have a track record – however limited – in commercial lending. However, these weak provisions are inadequate and leave too much discretion to the NCUA. As we emerge from the financial crisis and economic recession, this is the wrong time to jeopardize the safety and soundness of our financial system.

Credit Unions Not Fulfilling Their Tax-Exempt Mission

The purpose of credit unions' tax-exempt status and the cap on member business loans established by the 1998 law was to ensure credit unions would focus on serving members of modest means, not commercial lending. Numerous independent studies have concluded that credit unions are not fulfilling their core mission.

A 2005 study by the National Community Reinvestment Coalition determined that banks do a better job of fulfilling the credit unions' mission than the credit unions. The study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities." A 2003 Government Accountability Office study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks."

Another study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle and upper-income customers than lower-income households. Similarly, a study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base. The recent push by many credit unions into payday lending makes a travesty of their original tax-exempt mission. A recent investigation conducted by *The Washington Post* documents credit union payday lending abuses. While many credit unions offer short term, small dollar loans under reasonable terms, some credit union products are nearly as predatory as those offered by a store front check casher. The *Post* identified at least 15 credit unions that offer high cost loans closely resembling payday loans. In particular, some credit unions earn commissions by acting as fronts for third party lenders with names such as "QuickCash" and "CU on Payday."

Credit unions' involvement in a Florida real estate investment scheme, dubbed "Millionaire University," illustrates just how far credit unions have strayed from their original tax-exempt mandate of serving low and moderate income families. In this scheme a number of credit unions granted speculative out-of-market land development loans to residents from far away states. Borrowers became credit union 'members" by paying a \$5 dollar membership fee. Three of those credit unions failed. What original members were served in their home states of Colorado and Michigan when these credit unions made risky loans on Florida real estate? The fallout of these costly failures and ongoing litigation continues to have an impact on the entire credit union sector. Congress cannot allow tax-exempt credit unions to stray even further into such risky business lending endeavors by increasing the business lending cap while remaining subsidized by taxpayers.

Congress explicitly placed limits on the types of lending tax-exempt credit unions can do for a good reason – so credit unions can focus their efforts on serving people of modest means that share a common bond. This is not only better for local communities; it is also a much safer form of lending.

Credit Union Lending Comes at a Significant Cost to Taxpayers

The neglect of credit unions' original mission is unfair to the people credit unions were intended to serve; it's unfair to taxpaying community banks, but it's also unfair to all taxpayers. Some advocates of H.R. 1418 claim that expanded credit union commercial lending would come at "no cost to taxpayers." This is patently false. Lending by tax-exempt credit unions displaces lending by taxpaying banks, and thereby reduces tax revenue to the government. In light of the urgent need to reduce the federal budget deficit, we should apply a cost-benefit to the credit union tax exemption.

The most comprehensive analysis of the credit union's federal tax exemption was undertaken by the non-partisan Tax Foundation. This analysis considered not only the cost of the tax subsidy, but what happens to the tax subsidy – i.e., whether and to what extent it is passed on to customers – and the effect of the subsidy on the marketplace for financial services. The Tax Foundation study found that:

- The value of the tax subsidy was $2 billion in 2003 – and growing to over $3 billion annually today. This included not only the direct tax expenditure that resulted from not taxing the net revenue of credit unions, but the indirect effect on tax revenues of a less competitive marketplace for financial services. This is a more comprehensive analysis of the tax subsidy than is provided by the Joint Committee on Taxation and the Office of Management and Budget, which consider only the static tax expenditure and exclude behavioral changes in the marketplace. Still, JCT and OMB also confirm the dramatic growth of the tax expenditure in recent years.
- The subsidy would cost the taxpayer over $32 billion over a ten-year budget window.
- The subsidy boosted the return on assets, for the average credit union, by 50 basis points.
- Of those 50 basis points, only a meager 6 basis points are passed onto customers in the form of lower interest rates on loans. There is little to no effect on deposit rates. 11 basis points are absorbed by higher labor costs at a credit union than at a comparable bank (due to inefficiencies).

- The remaining 33 to 44 basis points of subsidy accrue to the credit union owners in the form of higher equity and larger assets they use to expand rapidly.

In summary, the Tax Foundation study shows that credit unions generally do not pass on their subsidy to customers. However, the competitive threat to community banks comes from the fact that credit unions have the *option* to use the subsidy to secure business they want. Given the projected growth in the federal budget deficit in the coming years and the threat it poses to our national prosperity, we can no longer afford a tax subsidy divorced from its original purpose that generates no public benefit and poses a threat to tax-paying community banks. This view is also shared by the Debt Reduction Task Force of the Bipartisan Policy Center, Chaired by former Senator Pete Domenici and former OMB Director Alice Rivlin, whose recent report recommends eliminating the tax exemption for credit unions. In addition, the Congressional Budget Office, in its annual "Budget Options" report, noted the option of taxing large credit unions. Any serious effort to reduce the deficit must consider the merits of repealing the credit union tax exemption. While I have focused my comments on the federal budget, the credit union tax exemption also deprives state and local governments, many of which are facing cuts to essential public services to remain solvent, of desperately needed revenue.

Recently, credit unions have been comparing their tax exemption to the tax status of S corporation banks. This comparison is false and dishonest. The Internal Revenue Service defines S corporations as corporations that elect to pass corporate income, losses, deductions and credits through to their shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. Taxed at the federal, state, and local levels, S corporation shareholders can pay at rates in excess of 40 percent.

Importantly, every dollar of net income is taxed annually on a *current* basis, whether or not it is distributed to the shareholders. An S corporation has no retained earnings that enjoy deferred taxation. The approximately 2,300 Subchapter S banks, about one third of all community banks, are proud to pay their fair share of taxes to support their communities. I am confident that no credit union would trade their tax-exemption for the tax status of an S corporation.

The recent bailout of corporate credit unions further demonstrates the fundamental unfairness of the tax exemption. On September 24, 2010 three corporate credit unions were taken into conservatorship by the NCUA, bringing the total to five over a period of 18 months. Seventy percent of corporate credit unions assets were held under conservatorship. The corporate credit unions had invested in $50 billion of subprime, private label, mortgage-backed securities, a failure of prudent lending illustrating that their judgment seems to have been no better than that of the Wall Street banks that also had to be bailed out. Had NCUA not intervened with the provision of a taxpayer-funded backstop, consumer credit unions would have suffered system-wide losses of an estimated $40 billion and as many as 30 percent of federal credit unions would have failed, according to NCUA estimates. Credit unions benefit from taxpayer resources when times are rough, but they do not contribute when they are profitable. This is an affront to taxpayers and to the community banks that sustain their communities and the nation with hard-earned tax dollars. Community banks pay their fair share; credit unions should be held to the same standard.

The case for repealing the exemption stands on its own merits as a deficit reduction measure. When considered in the context of the current effort by credit unions to expand their business lending powers and become the equivalent of banks, linking expanded lending powers to repeal of the tax exemption is a matter of fairness and free market principle. If credit unions seek to eliminate any distinction between their business model and that of a commercial bank, then Congress must tax them under any equitable tax system.

Credit Unions Could Convert to Mutual Thrifts

The implicit reason for expansion of member business lending proposed in H.R. 1418 appears to be that the current credit union charter is inadequate for the needs of some credit unions and their customers. However, ICBA believes that there is a far more appropriate alternative for them. If they need bank powers to better serve their customers, they should be encouraged to convert to a Federal savings association charter. Over 30 credit unions have taken advantage of this option, despite the substantial roadblocks that the National Credit Union Administration has put in the way of credit union-to-thrift conversions.

Conclusion

Thank you again for convening this important hearing. As a community banker, I feel the direct impact of credit union commercial lending, so I'm grateful for the opportunity to provide my perspective.

ICBA strongly urges this committee to reject calls for new powers for the tax-subsidized credit union industry that will not, despite assertions to the contrary, expand small business credit or create jobs. ICBA adamantly opposes H.R. 1418 as an unjustified and unfair credit union power-grab at the expense of taxpaying community banks and individuals. Credit unions should be granted no new powers as long as they remain tax exempt, avoid any CRA requirements, and are not even meeting their statutory mission to serve individuals of modest means.

Thank you for this opportunity to testify and express the views of the community banking sector.

Embargoed Until Delivery
2:00 p.m. EDT
October 12, 2011

STATEMENT

OF

THE HONORABLE DEBBIE MATZ
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"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

[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

[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.

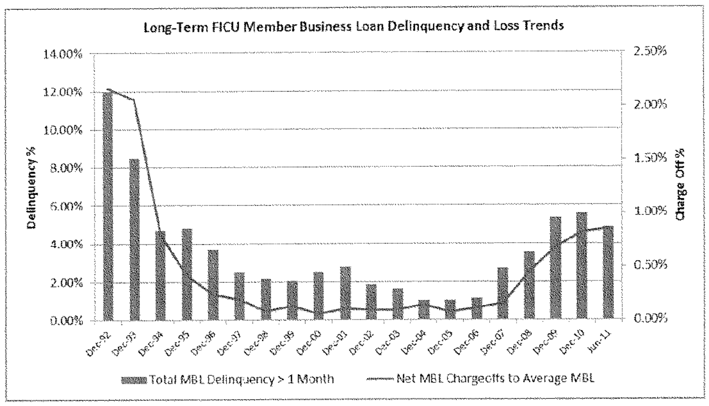
Since then, NCUA has increased supervisory oversight of credit unions involved in business lending, especially those in challenging markets. NCUA also began collecting more specific member business lending data on credit union Call Reports.

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.

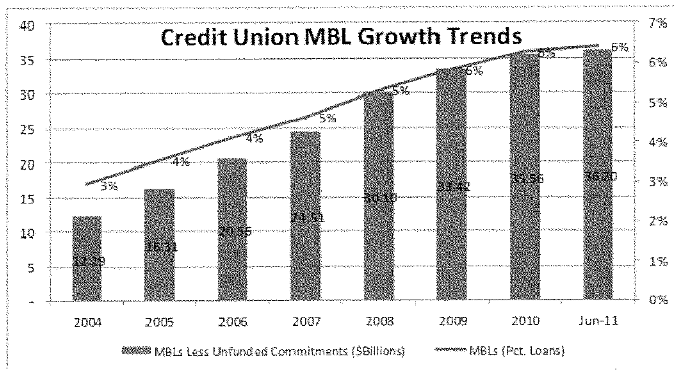
Credit Union MBL Statistics

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.

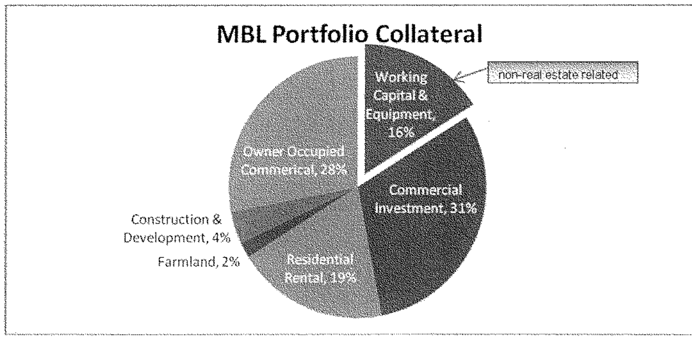
[18] Unless otherwise indicated, all data provided in this section is as of June 30, 2011.

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

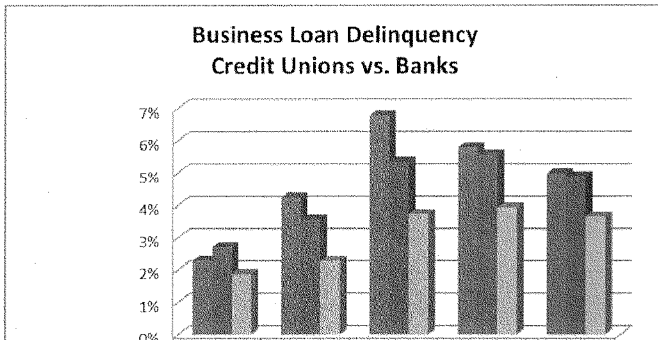
Like other types of loans, MBLs perform in a cyclical manner. Understandably, the member business lending portion of credit unions' loan portfolios has suffered from the adverse effects of the protracted economic downturn. The level of 60-day delinquent MBLs has increased from 0.53 percent at year-end 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.

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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.

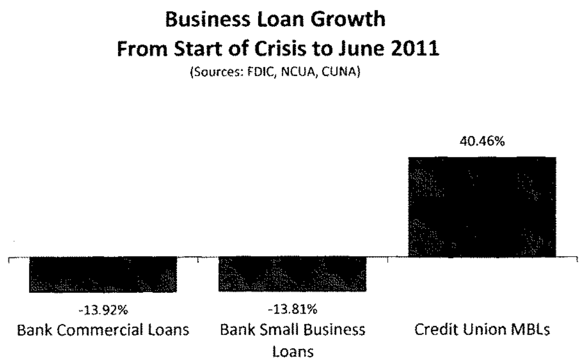
[3] See: http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey. Survey of firms with less than $5 million in annual revenues.

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.



Growth is for period 12/07 to 12/10 excepting bank small business loan growth which is for 6/08 to 12/10. Prior to 2010 banks reported small business loans outstanding only at mid-year.

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]

[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.

[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.

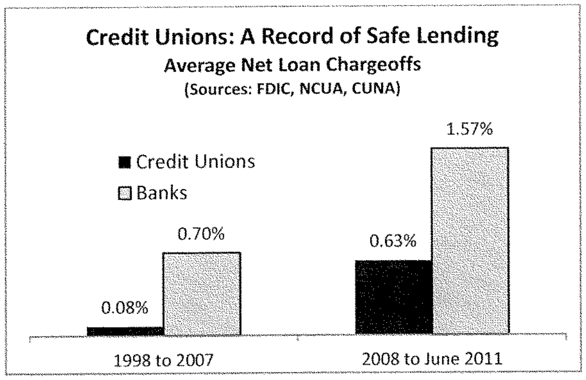
> "The Administration sees no safety and soundness basis for an amendment that would limit the ability of credit unions to make business loans to their members. Existing safeguards, coupled with the new capital and other reforms in the bill, are sufficient to protect against any safety and soundness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

[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.

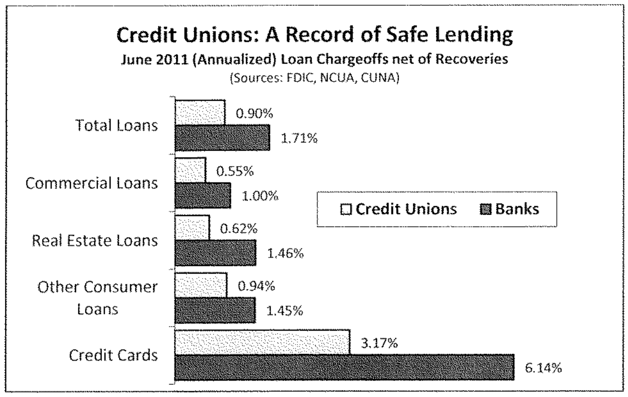


Compared to other loans at credit unions, business loan net charge-off rates are lower than net charge-off rates on credit union consumer loans and nearly identical to the net charge-off rates in credit union real estate loan portfolios.[21]

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]

[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.

CUNA
Credit Union National Association
cuna.org

BILL CHENEY
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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 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 paper 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

Statement for the Record of
The Credit Union Supplemental Capital Coalition

For the Hearing on

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

Before

The United States House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

October 12, 2011

Credit Union Supplemental Capital Coalition
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Subcommittee Chairman Capito, Ranking Member Maloney, and members of the House Financial Services Financial Institutions Subcommittee, thank you for the opportunity to submit this statement for the record on behalf of the Credit Union Supplemental Capital Coalition ("CUSCC").

CUSCC is a broad-based coalition representing federal and state chartered credit unions of all asset sizes and geographic diversity. Coalition members are united in their belief that access to supplemental capital is critical to credit unions' ability to continue to serve their historical role as sources of affordable financial services and as important sources of credit necessary to secure a lasting economic recovery in the broader economy. Access to supplemental capital is also essential to the long-term health and sustainability of the credit union system.

CUSCC commends the Subcommittee for convening this hearing on H.R. 1418, the Small Business Lending Enhancement Act of 2011. Member business lending and supplemental capital are distinct, but complementary issues. Both issues would modernize the credit union charter and allow credit unions to better serve the needs of their members.

CUSCC is pleased to note that the National Credit Union Administration ("NCUA") supports legislation to lift the restriction on credit union member business lending and legislation to permit supplemental capital for credit unions as part of the agency's larger regulatory reform initiative. The NCUA's leadership on both of these issues is critical.

As it happens, both issues arise from the same source, the Credit Union Membership Access Act ("CUMAA") of 1998. CUMAA was enacted in response to litigation in federal courts regarding fields of membership for federally chartered credit unions. As a compromise measure, CUMAA grandfathered NCUA's prevailing interpretation regarding fields of membership, in exchange for restrictions on credit union member business lending, a limitation on the statutory definition of "net worth," and the imposition of a capital-based supervisory prompt corrective action ("PCA") system comparable to that in place for federally insured banks.

However, while federal bank regulators have broad authority and flexibility to adjust capital requirements, credit union capital requirements are set in statute.

Under current law, the statutory definition of "net worth" excludes supplemental capital. A credit union's net worth ratio for regulatory compliance purposes is determined *solely* on the basis of retained earnings as a percentage of total assets.

This is a peculiar constraint. CUSCC is not aware of any other form of insured depository institution that is so limited. In fact, even within credit unions, this constraint is unique. There are two types of credit unions: corporate (wholesale) credit unions and natural person (retail) credit unions. Further, some natural person credit unions are low income credit unions. Under current law, corporate credit unions and low income credit unions are permitted to take supplemental capital. However, the great majority of credit unions – natural person credit unions that are not low income credit unions – are not permitted to take supplemental capital.

The restrictive statutory definition of net worth for natural person credit unions must be addressed. Because new deposits can outpace growth in retained earnings – especially during economic downturns when there is a consumer "flight to safety" – some well-managed credit unions have been forced to discourage deposits and curtail services from new and existing members to avoid diluting their net worth. Under PCA, reductions in a credit union's net worth category trigger mandatory supervisory restrictions; the NCUA has no discretion in imposing these supervisory actions, which include earnings transfers, restrictions on asset growth, restrictions on member business lending, and submissions of net worth restoration plans.

The result is what is referred to as the "PCA Trap." The PCA Trap is real and it harms consumers – especially those who are most in need of access to the affordable financial services that credit unions offer.

Specifically, the more successful a credit union is in attracting deposits from existing or potential members, the greater its assets (the denominator of the net worth ratio). But without an equally robust increase in its retained earnings (the numerator of the net worth ratio), there is increasing downward pressure on the net worth ratio. In large part, this is a sequencing issue; retained earnings cannot keep pace with the influx of deposits. Retained earnings can only be accumulated over time, whereas an influx of deposits can be much more dramatic and, often, much less predictable.

In order to preserve their net worth ratios, some healthy credit unions have been forced to manage their balance sheet and operations to discourage deposits. Additionally, some credit unions have been forced to lower interest rates on deposit accounts, thereby attracting fewer new members and fewer deposits from existing members, resulting in a reduction of funds available to make loans and provide other member services. A healthy, well-managed credit union that was planning to open three new branch locations may be forced to scale back to a single branch expansion. Perversely, these actions are not caused by challenging market conditions, but rather because of an artificial constraint on their ability to grow their regulatory capital. Healthy, well-managed credit unions are being penalized for their success in serving their members and meeting the financial needs of their communities. Moreover, credit union consumers, especially those who are most in need, are prevented from benefitting from reasonably priced financial services that credit unions offer.

The unprecedented financial and economic stress of the past few years has reinforced the need for flexibility with respect to capital requirements. Federal banking regulators have for many years had the authority and flexibility to adjust capital requirements in response to changes in economic and financial conditions. This is sound policy. Congress should likewise provide the NCUA with the authority to allow qualified credit unions, subject to appropriate regulatory oversight and consumer protections, to augment their retained earnings with supplemental capital as a means of managing their net worth levels under varying economic conditions.

A simple legislative modification would remedy this anomaly – providing the authority to the NCUA to develop, through notice and comment rulemaking, regulations that would permit supplemental capital under certain circumstances.

The specific forms of supplemental capital that would be made available to qualified credit unions would need to be established by the NCUA. A white paper published by the NCUA Supplemental Capital Working Group in 2010 makes clear that the preservation of the cooperative mutual model of credit unions must be a bedrock principle applicable to any form of supplemental capital for credit unions.

The primary mission of credit unions is to serve their members, rather than assuring shareholder profit. Credit unions are not-for-profit and are generally run by a volunteer board of directors. Access to supplemental capital would not disturb the cooperative and mutual structure fundamental to the credit union model. In the NCUA white paper, preservation of the cooperative mutual model is identified as a key principle for supplemental capital.

The NCUA white paper also makes clear that supplemental capital is not for all credit unions and must be closely regulated to assure adequate consumer protections and prudential safety and soundness constraints. From a systemic risk perspective, the NCUA and the National Association of State Credit Union Supervisors support supplemental capital because it would provide an additional buffer to the National Credit Union Share Insurance Fund.

CUSCC greatly appreciates the opportunity to submit this statement for the record. For further background, we have attached a March 2011 white paper titled "Reforming Credit Union Capital Requirements," authored by Professor James A. Wilcox, Lowrey Professor of Financial Institutions at the University of California, Berkley. Framed in the broader historical context of capital reform, the Wilcox paper concludes that empowering the NCUA to permit supplemental capital for credit unions would promote the safety and soundness of the credit union system; enhance credit union member services, including increased savings and lending activity; and benefit the broader economy and help speed up the economic recovery.

We are happy to be a resource to Congress, the Committee, and the Subcommittee and we look forward to our continued work together on these important issues.

ATTACHMENT

REFORMING CREDIT UNION CAPITAL REQUIREMENTS

JAMES A. WILCOX

LOWREY PROFESSOR OF FINANCIAL INSTITUTIONS
UNIVERSITY OF CALIFORNIA, BERKELEY

MARCH 3, 2011

James A. Wilcox

James A. Wilcox is the Lowrey Professor of Financial Institutions at the Haas School of Business at the University of California, Berkeley.

Jim has published widely on banking and credit unions, on housing and mortgage markets, on monetary policy, and on interest rates. His articles have been published by the top academic economics and finance journals.

Jim teaches courses on macroeconomics, on financial markets and institutions, and on risk management at financial institutions. Jim has won several awards at Berkeley for his teaching. He has also served as Chair of the Finance Group at the Haas School.

From 1999-2001, Jim was the Chief Economist at the Office of the Comptroller of the Currency in Washington, DC. Previously, he had served in Washington as the senior economist for monetary policy and macroeconomics for the President's Council of Economic Advisers under President George H. W. Bush and as an economist for the Board of Governors of the Federal Reserve System. He is also a Visiting Scholar at the Federal Reserve Bank of San Francisco and is a Fellow of the Wharton Financial Institutions Center and the Filene Research Institute. Jim received his Ph.D. in economics from Northwestern University.

Jim's homepage (http://www.haas.berkeley.edu/finance/wilcox.html) provides more information and access to some of his publications.

Executive Summary

This paper analyzes the role of capital requirements for financial institutions generally and the need for carefully regulated, but expanded capital authority for credit unions in particular. This paper responds, in part, to a 2004 report of the Government Accountability Office (GAO), which concluded that the limited capital authority of credit unions was adequate at that time. The tremendous upheaval in the financial markets and the credit crisis that accompanied the Great Recession of 2007-2009 compel a different conclusion today. The financial landscape has undergone permanent and dramatic changes and the capital authority of credit unions must evolve in response to these changes.

Current credit union capital requirements restrict credit unions' ability both to act as safe harbors for depositors and to act as a countercyclical source of lending. With better access to capital, not only could the safety and soundness of credit unions be enhanced, but credit unions would be positioned to offset the reduction in bank lending that has contributed to past recessions and slowed the current economic recovery.

Recognizing the dynamic nature of financial markets and its risks, Congress has historically provided federal banking regulators with the flexibility to adjust capital requirements in response to changes in economic and financial conditions. This is sound policy. Congress should likewise provide the National Credit Union Administration (NCUA), the federal credit union regulator, with the authority to develop appropriate capital requirements for credit unions and update them as conditions warrant.

Empowering the NCUA to develop appropriate capital requirements for credit unions would promote three important policy objectives:

- Expanded capital authority for credit unions would promote the safety and soundness of the credit union system;
- Expanded capital authority would allow credit unions to enhance their ability to serve their members (increased deposits and lending) and improve the efficiency of their operations; and
- Expanded capital authority for credit unions would benefit the broader economy and help speed up the economic recovery.

This white paper is organized as follows:

- Section I briefly reviews how, over many decades, continual, but unexpected, changes in economic and financial conditions and risks have frequently prompted policymakers to adjust capital requirements for depository institutions.
- Section II explains why current credit union capital requirements must be reformed.
- Section III shows how current capital requirements for credit unions discourage economic and operational efficiency.
- Section IV presents our recommendation that Congress delegate to the NCUA the authority to determine for credit unions what counts as capital and the effective required minimum amounts.
- Section V lays out some of the specific issues that the NCUA should consider in its reform of capital regulations.
- Section VI summarizes the implications of our analysis.

I. Continual, inherently unpredictable changes in economic and financial conditions have required policymakers to frequently update capital requirements.

A. The dynamic nature of economic and financial markets necessitates constant reassessment of the requirements governing financial institutions.

There are continually enormous shifts in the economic and financial landscape. Although the occurrences take place with some frequency, they have significant repercussions and they are largely unpredictable. Examples in recent decades include: stagflation during the 1970s; banking crises during the 1980s and early 1990s; falling inflation, unemployment, and interest rates from the mid 1980s through the mid 1990s; booms in the stock and housing markets starting in the mid 1990s; and the recent severe problems in housing, the financial sector, and the overall economy. In addition to such changes in the landscape, there have been and no doubt will continue to be unexpected changes due to financial innovations and due to changes in financial regulations themselves.

In this context, financial regulations seek to contribute to the efficient operation of the financial system, the safety and soundness of financial institutions, and to contain systemic risk. Among the tools used to advance this objective are competition regulations, supervision of financial institutions, deposit insurance, and capital requirements. Because of the dynamic nature of economic and financial markets, the contours and relative use of these tools must be continuously reassessed.

B. Capital requirements are an important tool in the oversight of financial institutions and have been modified over time to reflect changes in the economic and financial landscape.

Capital requirements provide a good example of ongoing reassessments. A primary role of capital in depository institutions is to support their operations by absorbing shocks from the unexpected. The greater the proportion of operations that is financed by capital, the more likely an institution will survive periods of adversity.

Failure of depository institutions imposes direct and indirect costs on many parties. Direct costs include losses to stockholders, bondholders, other creditors, uninsured depositors, and the deposit insurer, with much of the costs to the latter passed on to other depository institutions or, in some cases, taxpayers. Indirect costs include (1) those borne by borrowers, depositors, and communities who might lose established business relationships and (2) the disruption of the normal operation of the payment and credit systems for the broader economy. Thus, the objective of imposing higher capital requirements is to reduce the risk of failure, thereby reducing both these direct costs to the deposit insurer and others and indirect costs on communities and the economy at large.

Over the decades, policymakers have continuously modified the structure of capital requirements for both commercial banks and credit unions to reflect changing economic and financial conditions.

1. Congress has delegated broad authority to federal bank regulators to enable timely and flexible adaptations of capital requirements.

Designing capital requirements and updating them as conditions change required consideration of several factors. For example, some of the earliest and largest declines in commercial bank capital ratios largely reflected banks' and bank regulators' views that public policies had reduced some risks for individual banks. The Federal Reserve, launched in 1913, provided banks with short-term liquidity and the Federal Deposit Insurance Corporation (FDIC), launched in 1934, insured depositors' funds. The resulting reductions in liquidity risks meant that banks could prudently hold smaller capital cushions, which had reached levels as high as 40% during the nineteenth century. Higher capital requirements could also restrict depository institutions' capacity to lend and, particularly during recessions, affect economic growth. Given the multi-faceted nature of this task, throughout most of the 20th century, bank supervisors did not use specific, industry-wide capital requirements but, rather, tailored informal rules to the circumstances of individual institutions.[1]

However, by the 1980s, conditions had changed profoundly, resulting in large numbers of U.S. thrift and bank failures and the imposition of very large losses for deposit insurers. Responding in part to changed conditions and their aftermaths, bank regulators in the U.S. and other industrialized countries developed the Basel Accord in 1988 (i.e., Basel I), which set forth internationally-standardized explicit capital requirements.[2] Congress transposed part of the Basel Accord into statute by including a section on prompt corrective action (PCA) in the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991.[3]

Basel I highlights how policymakers periodically reassess capital requirements. By increasing the effective capital requirements on internationally-active banks Basel I emphasized reducing the direct losses imposed on deposit insurers. Congress required federal banking regulators to "take prompt corrective action to resolve the problems of insured depository institutions ... at the least possible long-term cost to the Deposit Insurance Fund."[4] The objective was to reduce losses by identifying troubled depository institutions early enough to prevent potential losses from becoming larger. For instance, Congress specifically required federal bank regulators to appoint a receiver (or conservator) no later than 90 days after a bank's

[1] See FDIC. 2003. "Basel and the Evolution of Capital Regulation: Moving Forward, Looking Back." www.fdic.gov/bank/analytical/fyi/2003/011403fyi.html.
[2] In July 1988, the Basel Supervisors Committee, comprising representatives from Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the U.K. and the U.S., issued "International Convergence of Capital Measurement," which is widely known as the Basel Accord (or Basel I).
[3] Section 131 FDICIA added section 38 to the Federal Deposit Insurance Act (FDIA). This section is codified as 12 U.S.C. 1831o.
[4] 12 U.S.C. 1831o(a)(1).

tangible equity falls below 2% of total assets.[5] Congress further required federal bank regulators to develop sets of industry-wide, specific capital requirements[6] and for depository institutions found to be undercapitalized under those requirements to forgo asset growth and to submit capital restoration plans.[7] These requirements also encouraged depository institutions to issue various securities other than common stock (e.g., subordinated debt) that might reduce the direct costs that failures impose on deposit insurers.[8]

2. <u>In contrast, capital requirements for credit unions are set in statute, denying NCUA the regulatory flexibility to adjust capital requirements in response to changing conditions.</u>

In the case of credit unions, capital requirements have been set by statute. Consequently, Congress has had to revisit the issue of capital requirements repeatedly as economic and financial conditions have changed. State legislatures and, in 1934, Congress first set capital requirements not as percentage of assets, but as a percentage of earnings that was to be added to reserves (i.e., capital).[9] In 1949, Congress permitted federal credit unions to forgo accumulating more capital once they met higher, preset capital-to-deposit ratios.[10] In 1970, Congress established share (i.e., deposit) insurance for credit unions; in conjunction, Congress introduced

[5] 12 U.S.C. 1831o(g)(3)(A) and 12 U.S.C. 1831o(c)(3)(B)(i).
[6] 12 U.S.C. 1831o(c)(1) requires federal banking agencies to develop capital requirements based on total assets (i.e., a leverage limit) and risk-based assets. The section also authorizes federal banking agencies to rescind those requirements and to set up others.
[7] 12 U.S.C. 1831o(e)(3).
[8] Consider a simplified example with two institutions A and B. Institution A has $100 in assets, $92 in insured deposits, and $8 in equity. Institution B has $100 in assets, $88 in insured deposit, $4 in subordinated debt, and $8 in equity. If loan losses reduce the value of assets in both institutions to $80, losses to the deposit insurer would be $12 from institution A and $8 from institution B. Thus, losses to the deposit insurer would be lower at the institution that relied more on subordinated debt.
[9] Section 12 of the Federal Credit Union (FCU) Act of 1934 (Public law 467 – 73rd Congress) required that "20 per centum of the net earnings of each year, before the declaration of any dividends, shall be set aside … as a reserve fund against possible bad loans." Most states set up credit union laws with similar capital requirements from as early as 1909.
[10] In 1949, Public law 376 – 81st Congress stated "when the regular reserve thus established shall equal 10 per centum of the total amount of members' shareholdings, no further transfer of net earnings to such regular reserve shall be required except that such amounts not in excess of 20 per centum of the net earnings as may be needed to maintain this 10 per centum ratio shall be transferred." Among the states, New York, for instance, similarly amended its credit union law in 1925.

several changes that effectively lowered capital requirements.[11] In 1977, Congress once again lowered credit union capital requirements.[12]

The relationship between changes in formal capital requirements and actual capital-to-asset ratios is complex. Figure 1 presents an estimate[13] of the credit union capital-to-assets ratio during 1911-2010Q3. Despite loosening in capital requirements in 1949 and 1977, capital-to-asset ratios increased substantially in the following years. The loosening in 1970, coinciding with the introduction of federal insurance for credit union deposits, was followed by a substantial decline in the aggregate credit union capital-to-asset ratio. Nonetheless, despite additions to reserves being set as a fraction of earnings until 1998, over the long-term, credit union capital-to-asset ratios steadily increased from 0.96% in 1911, to 6.68% in 1933, 8.00% in 1970, and 11.01% in 1997 (immediately before CUMAA).[14]

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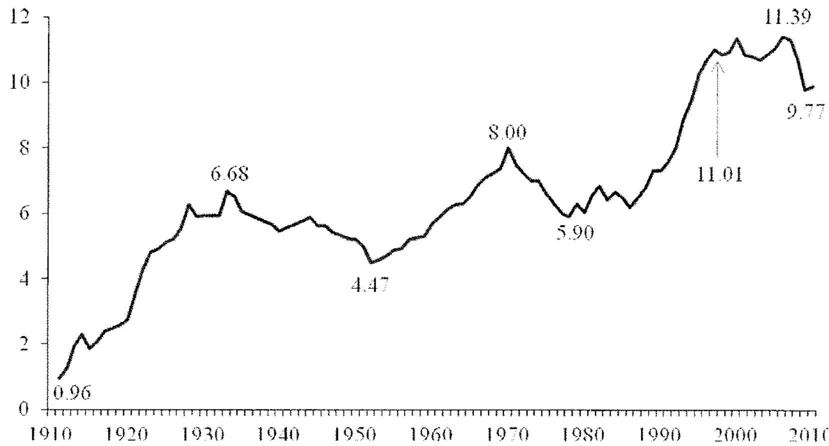
[11] See Harold Black and Robert H. Dugger. 1981. "Credit Union Structure, Growth, and Regulatory Problems." The Journal of Finance XXXVI(2): 529-538. Congress changed the capital-to-deposit ratio into a capital-to-risk assets (i.e., largely loans) ratio. A lower capital ratio was also added, above which credit unions would have to set aside smaller fractions of earnings. Congress also modified the formula for the amount of capital to be set aside from a fraction of net earnings (after noninterest expenses) to a fraction of gross earnings (before noninterest expenses). In particular, Public Law 91-468, Section 9 states "set aside ... as a regular reserve ... 10 per centum of gross income until the regular reserve shall equal 7½ per centum of the total of outstanding loans and risk assets, then 5 per centum of gross income until the regular reserve shall equal 10 per centum of the total of outstanding loans and risk assets."

[12] Section 305(b) of the Depository Institutions Act of 1977 (Public law 95-22) states "a credit union in operation for more than four years and having assets of $500,000 or more shall set aside (A) 10 per centum of gross income until the regular reserve shall equal 4 per centum of the total of outstanding loans and risk assets, then (B) 5 per centum of gross income until the regular reserve shall equal 6 per centum of the total of outstanding loans and risk assets."

[13] Attaining complete consistency since 1911 is problematic. We estimated the credit union capital-to-assets ratio that we plotted in Figure 1 as follows. We used the ratio of regular reserves to assets in Massachusetts and New York credit unions for 1911-1928, the same ratio for all (nationwide, state- and federally-chartered) credit unions for 1929-1951, the ratio of regular reserves plus undivided income (i.e., net worth) to assets for federal credit unions for 1952-1969, the ratio of regular reserves plus undivided income and the allowance for loan losses to assets for all credit unions for 1970-1979, and the ratio of regular reserves plus undivided income (i.e., net worth) to assets for all credit unions for 1980-2010Q3.

[14] The aggregate capital-to-assets ratio did not increase linearly throughout the overall period, reaching lows of 4.47% in 1952 and 5.90% in 1978.

Figure 1
Credit Union Capital-to-Assets Ratio
(%, annual, 1911-2010Q3, BLS, CUNA, NCUA)



3. Congress last adjusted credit union capital requirements in 1998 in response to a bank problem, not a credit union problem.

When Congress mandated federal bank regulators to develop specific numerical capital requirements in 1991, it did not address the structure of credit union capital requirements. Perhaps the relatively better performance of credit unions during the 1980s and early 1990s and judgment that credit unions then posed much less risk to their deposit insurance fund left the focus almost entirely on banks and their problems. As shown in Figure 2, credit union capital-to-asset ratios were higher than those at commercial banks throughout the 1980s. Further, the credit unions' deposit insurer, the National Credit Union Share Insurance Fund, NCUSIF, remained solvent, unlike those for commercial banks and thrifts, and NCUSIF losses were far lower

(0.018% of insured deposits in 1971-2004) than those that commercial banks (0.073%) imposed on the FDIC.[15]

Figure 2
Capital to Asset Ratio:
Credit Unions and Commercial Banks
(%, annual, 1910-2010Q3, BLS, CUNA, NCUA, Fed, FDIC)

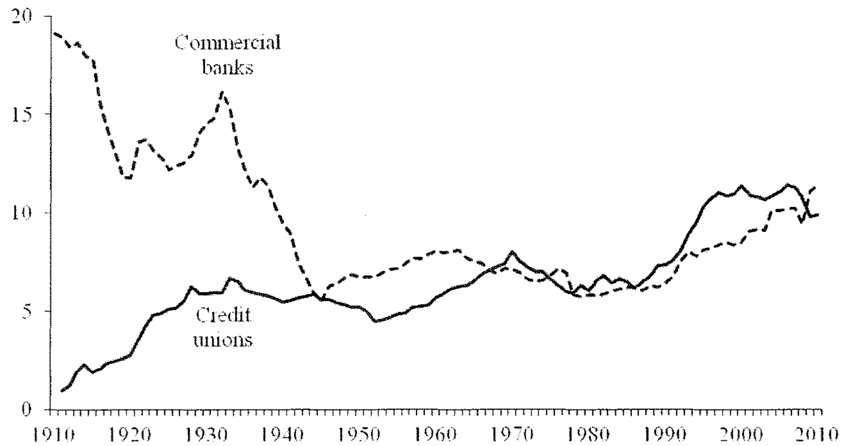
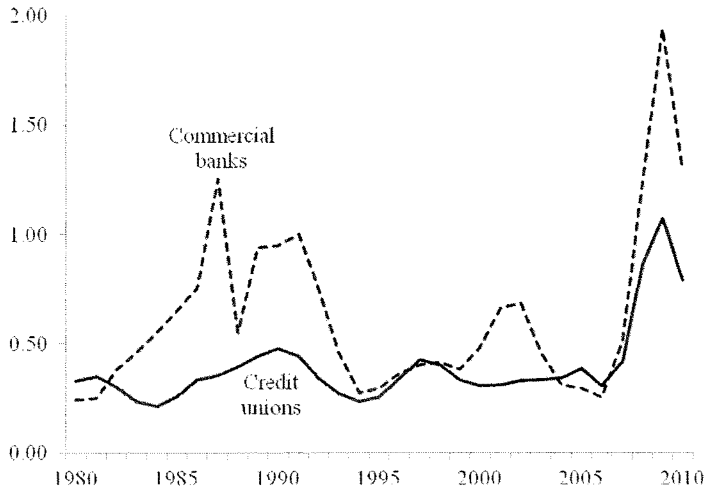


Figure 3 compares credit unions' and commercial banks' provisions for loan losses per assets during 1980-2010Q3. The figure similarly shows that provisions for loan losses at credit unions during the late 1980s and early 1990s were far smaller than those at commercial banks.

[15] James A. Wilcox. 2005. "Failures and Insurance Losses of Federally-Insured Credit Unions: 1971-2004." Filene Research Institute, Madison, WI.

Figure 3
Provisions for Loan Losses per Assets:
Credit Unions and Commercial Banks
(%, 1980-2010Q3, NCUA, FDIC)



Congress eventually enacted minimum capital-to-asset requirements for credit unions several years later, in 1998, at a time when overall economic and financial conditions had improved and losses to the deposit insurer had largely subsided for both commercial banks and for credit unions.

It is important to note that Congress did not introduce minimum capital-to-asset requirements for credit unions directly as a result of a crisis or emergency among credit unions. Rather, in response to litigation in federal courts regarding credit union fields of membership (FOM), Congress engaged in a wide-ranging overhaul of the credit union regulatory system. Through the Credit Union Membership Access Act (CUMAA) of 1998,[16] Congress grandfathered the FOM expansions that the NCUA had granted to credit unions since the 1980s.

[16] Public law 105-219.

However, Congress also introduced restrictions for credit union member business lending, explicitly permitted the conversion of credit unions into mutual savings banks (and thus eventually into stock-owned institutions), and introduced a very detailed schedule of minimum capital-to-asset requirements for credit unions. Since (1) credit unions had suffered far lower loan losses during the 1980s, (2) credit unions had imposed far lower losses on their deposit insurer (and none on taxpayers), and (3) credit union capital-to-asset ratios had already climbed from 5.90% in 1978 to 11.01% in 1997, CUMAA largely appears to have applied to credit unions the solution to a bank problem.

4. The Great Recession of 2007-2009 has forced policymakers to reevaluate capital requirements, demonstrating once again the need for regulatory flexibility.

The recent housing, financial, and economic crises have demonstrated the need to renew discussions on capital requirements among international bank regulators (i.e., Basel III).[17] These discussions reflect yet another shift in emphasis among bank regulators, from reducing the direct costs of failures to reducing the risks that a financial institution will fail. While regulators will continue to close depository institutions with very low capital levels, Basel III also proposes to use higher capital ratio triggers to provide bank managements with incentives to avoid capital ratios falling too far, which would increase the likelihood of failures. For instance, under Basel I, banks with core capital that is less than 4% of risk-based assets were considered undercapitalized and were required to forgo asset growth. Under Basel III, banks with core capital that is less than 7% of risk-based assets would be required to forgo dividends (to stockholders) and bonuses (to executives).

[17] An earlier round of discussions, Basel II, was only in its earliest stages of implementation abroad and, particularly, in the U.S. and has largely been superseded by the recent crises and Basel III.

Basel III will also require banks to set up a "capital conservation buffer" of up to 2.5% to capital ratios when economy-wide credit growth is abnormally high.[18] This is consistent with Section 616 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public law 111-203), which also requires that "each appropriate federal banking agency shall seek to make the capital standards ... for insured depository institutions countercyclical so that the amount of capital required ... increases in times of economic expansion and decreases in times of economic contraction."

Basel III will further tighten risk-based capital requirements by restricting the types of items that may be counted as capital and shifting various types of assets from lower-risk to higher-risk categories. Thus, the Basel Committee estimated that while the 91 largest banks in the world reported on average capital equal to 11.1% of risk-based assets under the old rules, the same capital would only equal 5.7% of risk-based assets under the new rules.[19] Basel III may also shift the nature of instruments that count as capital, from those that would solely reduce deposit insurer losses due to failures to new instruments that would reduce the likelihood of failures. For example, upon reaching a preset, low capital ratio, such instruments would automatically reduce the depository institutions' liabilities (and increase their capital ratios to higher levels), thereby reducing their likelihoods of failure.[20]

Thus, Basel III effectively requires banks not only to hold more capital, but also to hold forms of capital that are more likely to help institutions to survive. While federal banking regulators have yet to implement Basel III entirely, having agreed on them in international

[18] Abnormally high credit growth is to be detected comparing recent credit growth and the historical trend using Hodrick-Prescott statistical filters (Financial Times, "Basel III," January 12, 2011, P. 12).
[19] Financial Times, "Basel reveals liquidity gap for world's biggest banks," December 17, 2010.
[20] These instruments would reduce a depository institution's liabilities either by reducing their face value irrevocably or by converting into common shares. The trigger for these reductions could be breaching a preset capital ratio, an announcement from bank regulators, or a decision to otherwise inject public funds into the depository institution. Financial Times, "Tough requirements on bonds that banks count toward capital," January 14, 2011, P. 14.

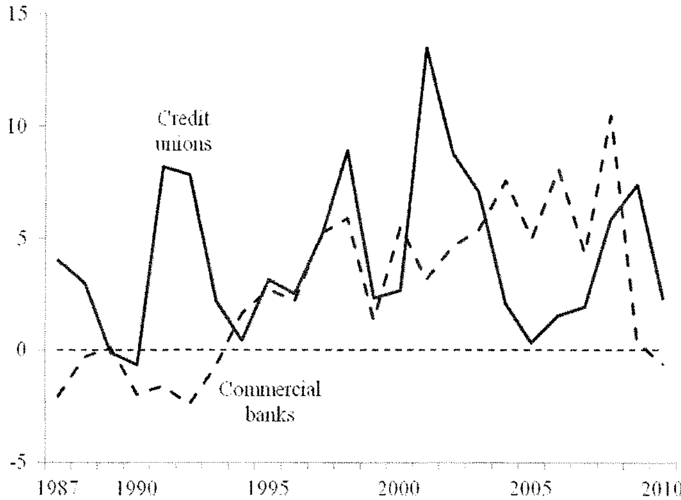
discussions, U.S. banking regulations are very likely to be implement many of its provisions in coming years.

II. Current capital requirements restrict credit unions' abilities to serve as safe harbors for depositors and to offset the pro-cyclicality of commercial banks' lending, abilities that historically have helped speed up and strengthen recovery when the economy has needed it most.

In recent decades, credit unions have served as "safe harbors" for depositors when financial markets were clouded with uncertainties or in turmoil (as in 2001 or 2009). In times like these, when savers had suffered sharp losses, flows out of stock and bond markets often seemed to seek refuge in credit unions. Figure 4 compares growth rates of credit unions' and commercial banks' inflation-adjusted deposits during 1987-2010Q3. Over this extended period, credit union deposits grew faster (4.2% annually) than commercial bank deposits (2.7%), due to credit unions' generally more favorable interest rates and other factors.[21] Notably, credit union deposit growth was fastest during and after the recessions and financial market problems of 1990-1991, 2001, and 2007-2009. In contrast, deposit growth was more subdued during the boom years of the mid 2000s. The pattern of commercial bank deposit growth in these episodes was decidedly different from that of credit unions: Bank deposits shrank in 1990-91 and 2007-2009, but grew more strongly during the boom years of the mid 2000s.

[21] The fraction of deposits in credit unions (out of those in credit unions and commercial banks) has grown steadily over the decades passing 1% in 1954, 2% in 1960, 3% in 1969, 4% in 1975, 5% in 1985, 6% in 1986, 7% in 1991, 8% in 1992, and 9% in 2001.

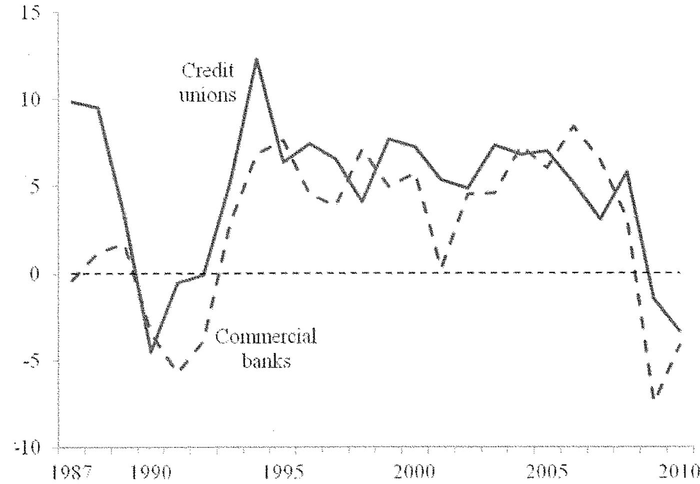
Figure 4
Deposit Growth
(%, annual, inflation adjusted, 1987-2010Q3, CUNA, FDIC, BLS)



Credit unions have traditionally also played a countercyclical role, helping to counterbalance declines in commercial bank lending that often occurred when the overall economy was weak. Figure 5 compares credit union and commercial bank growth in inflation-adjusted loans during 1987-2010Q3. Commercial banks cut back lending deeply during and after the recessions of 1990-1991 and 2007-2009. In contrast, credit unions reduced their lending far less than banks during and after the 1990-1991 recession (largely maintaining it in 1991 and 1992), maintained lending growth at rates consistent with a growing economy during and after the 2001 recession, and reduced their lending substantially less than banks during and after the 2007-2009 recession.[22]

[22] While the nominal value of credit union loans did increase from 2007 to 2008 and from 2008 to 2009, Figure 5 highlights that credit unions may still be unable to fund creditworthy borrowers. As the figure shows, credit union

Figure 5
Loan Growth
(%, annual, inflation adjusted, 1987-2010Q3, CUNA, FDIC, BLS)



Note: We adjusted reported commercial bank lending downwards by about $250 billion in 2010 to take into account the effects of FASB 166 and FASB 167 requiring banks to consolidate previously unconsolidated securitized lending.

Credit union lending has consistently been more countercyclical than that of commercial banks in the recent decades. Figures 4 and 5 also show that credit unions' ability to counterbalance banks has varied with the structure of credit union capital requirements, as well as with other conditions. Thus, during and after the 1990-1991 recession, when they were not subject to minimum capital-to-asset requirements, credit unions were able to provide safe harbors for depositors and were largely able to support lending during 1991-1992.

lending both fell once adjusted for inflation and grew at rates far below those consistent with average long-term economic growth. (The nominal value of credit union loans did fall from December 2009 to September 2010.)

A. Relatively high capital ratios at credit unions after the 2001 recession led the GAO to conclude in 2004 that credit union capital requirements were adequate at that time.

During and after the 2001 recession, many individual credit unions became concerned that heavy deposit inflows were pushing them down to minimum capital-to-asset ratios. On the whole, however, credit unions were able to provide safe harbors to depositors and to maintain loan growth rates that were consistent with sustained growth of the economy. In light of these conditions and results, a 2004 report by the Government Accountability Office (GAO)[23] concluded that credit unions could service their members adequately under the prevailing capital-to-assets requirements. However, the GAO report made little allowance for the reality that events and conditions were predictably going to change in unpredictable ways.

1. <u>GAO's snapshot in time must be revisited in light of recent, dramatic changes in the financial landscape</u>.

The 2007-2009 recession highlighted the shortcomings in current credit union minimum capital-to-asset requirements. The then-prevailing, and still-prevailing, structure of capital requirements did not substantially restrict credit unions in the aggregate during and after the 2001 recession because, at the onset of the 2001 recession, the aggregate credit union capital-to-asset ratio was high and the modest loan losses meant that provisions for loan losses per assets needed to be increased only slightly. With provisions remaining between 0.31% and 0.34% every year within 1999-2004 (see Figure 3 above), credit union deposits grew 13.5% from 2000 to 2001 and the average capital-to-asset ratio fell less than 1%, from 11.36% to 10.86%.

[23] Government Accountability Office. 2004. "Credit Unions: Available Information Indicates No Compelling Need for Secondary Capital." Washington, D.C.

2. GAO failed to address how capital authority could restrict credit union operations during a recession.

In contrast, credit union minimum capital-to-asset requirements substantially restricted credit unions' abilities to accept deposits and extend credit during and after the 2007-2009 recession. Credit unions endured large and rapid declines in capital: The aggregate capital-to-asset ratio fell from 11.39% in 2006 to 9.77% in 2009, with many much larger declines at individual credit unions. As a result of capital pressures, many credit unions have been forced to limit their traditional role as safe harbors for depositors, accommodating far less deposit growth than during and after past recessions, and have cut their inflation-adjusted lending substantially. Some credit unions have been forced to ask large depositors to temporarily shift their deposits elsewhere.

III. Reforming capital requirements would improve credit unions' ability to bolster safety and soundness, while enabling better service to members and helping to speed up and strengthen the national economy's recovery.

A. In contrast to banks, credit unions cannot access supplemental capital.

Current credit union capital requirements, as defined in detail in statute, unfortunately combine (1) the minimum capital-to-asset requirements that apply to banks and (2) a holdover from pre-CUMAA credit union legislation by which only retained earnings may count toward credit union capital requirements.[24] Commercial banks are sensibly allowed to meet an asset-based capital requirement by using a combination of retained earnings and capital instruments. Being able to use capital instruments greatly helps banks to meet capital requirements as conditions change, whether because of (1) increases in assets (whether driven by deposit inflows

[24] According to 12 U.S.C. 1757a(c)(2), low-income credit unions may also count secondary capital accounts as net worth and, thus, toward capital requirements. Risk-based credit union capital requirements also count other items, such as allowance for loan losses. In December 2009, 1,085 credit unions were classified as low income (14% of credit unions but, being on average smaller, holding only 4.2% of credit union assets). Among low-income credit unions, only 40 have outstanding amounts of secondary capital. Their secondary capital accounts for 4.4% of their assets but 39% of their net worth.

or the pursuit of valuable loan opportunities) or (2) decreases in their capital (e.g., loan losses or falls in the values of assets held). However, as a result of the pre-CUMAA holdover that allows only retained earnings to be counted toward their capital requirements, U.S. credit unions – unlike commercial banks, stock-owned and mutually-owned thrifts, stock-owned and mutually-owned insurance companies, and even credit unions abroad[25] – are not able to remedy shortfalls of their actual capital ratios below regulatory minimums by issuing capital instruments.

Modifying credit union capital requirements from a minimum fraction of earnings to a minimum fraction of assets fits within a long tradition of capital updates specified by Congress. Prior to CUMAA, credit unions with high enough capital-to-loan ratios were not required to set aside additional reserves from earnings, but credit unions with low capital-to-loan ratios were required to do so. In CUMAA, Congress imposed on low-capitalized credit unions penalties that were similar to those it had mandated for low-capitalized banks. However, Congress did not provide the corresponding authority for the NCUA to permit credit unions to raise supplemental capital – a key tool available to banks.

As a result, credit unions with low capital-to-asset ratios can no longer meet their requirements by retaining a fixed fraction of low earnings (e.g., 10% of gross earnings), but rather have to retain over time whatever amount of earnings is necessary to close potentially large shortfalls of their actual capital ratios below the new legislated minimums. Until credit unions meet the capital-to-asset requirements, Congress requires them to forgo growth in assets.[26] To improve current credit union capital requirements, Congress should retain capital

[25] For example, in Canada, credit unions are able to issue certain forms of supplemental capital.
[26] Section 216(c)(1)(C) of the FCU Act (as amended by CUMAA) states that "an insured credit union is 'undercapitalized' if it has a net worth ratio of less than 6 percent." Section 216(g)(1) states that "an insured credit union that is undercapitalized shall not generally permit its average total to assets to increase." For instance, a credit union with a net worth-to-loans ratio of 6% (or about 4% of assets) in 1997 (i.e., one then not required to set aside more reserves under pre-CUMAA legislation) would have to set aside an additional 2% of assets as reserves before it was allowed to grow again.

requirements as a minimum fraction of assets but allow credit unions, subject to appropriate regulatory oversight, access to supplemental capital.

It is important to note that some capital instruments currently used by banks or other financial institutions convey voting rights and are, thus, not consistent with credit union governance structures. However, most financial institutions other than credit unions[27] can use several other, non-voting instruments (e.g., preferred stock, subordinated debt, and other hybrids) or items (e.g., the allowance for loan losses) to meet capital requirements.[28]

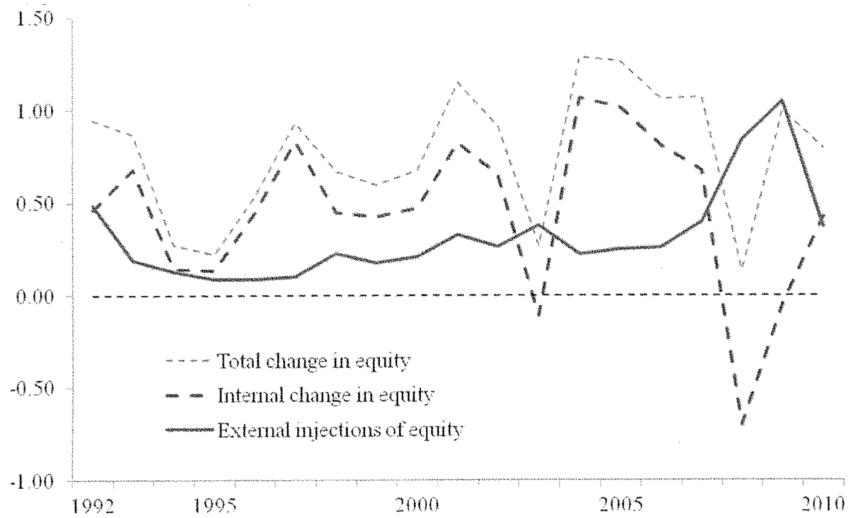
B. Access to supplemental capital strengthens depository institutions and benefits the economy.

The ability to raise supplemental capital is important for banks during both normal and troubled times. Figure 6 presents commercial banks' capital raised internally (e.g., retained earnings, changes in values of securities held, and restatements), raised externally (e.g., capital instruments sold and injections from their parent bank holding companies, BHCs), and the total of the two. Commercial banks routinely rely on raising capital externally: They obtained 27% of their increased capital externally during normal times (e.g., 1993-2006 or the period between, or excluding, the two most recent banking crises). However, commercial banks relied even more heavily on raising capital externally (at 93% of their increases in capital) during troubled times (e.g., 2007-2010). The figure also shows that commercial banks' external capital raising allowed them to increase their equity levels despite enduring large losses (i.e., despite negative internal changes in equity).

[27] Under some circumstances, some of these instruments are also already counted as capital for credit unions. Low income credit unions may count subordinated debt as net worth, and complex credit unions may count the allowance for loan losses toward their risk-based requirements.

[28] As we describe elsewhere, while international discussions are reassessing the characteristics to be permitted in the future for such instruments, Congress and federal bank regulators continue to anticipate a role for non-voting instruments in capital requirements.

Figure 6
Changes in Commercial Bank Equity:
Internal (e.g., retained earnings, changes in values of securities held, and restatements),
External (e.g., capital securities sold and injections from their parent BHCs), and Total
(% of assets, annual, 1992-2010Q3, FDIC)



C. The lack of access to supplemental capital harms credit unions, their members, and the broader economy.

Without access to supplemental capital credit unions are restricted in their ability to respond to changes in conditions. Credit unions faced with loan losses and/or with lower capital ratios have to restrict the growth of their assets. In effect, to deter deposit inflows, these credit unions are forced to offer their members worse interest rates on deposits than available at other institutions. To build capital by retaining earnings, these credit unions would also have incentives to close branches, reduce employment, and charge higher interest rates on loans, thereby limiting their services to their members. Because of these restrictions, credit unions cannot provide the safe harbors for savers or extend the requisite amount of loans to creditworthy borrowers.

Federal bank regulators commonly view the use of capital instruments as a part of prudent financial management and as an aid to safety and soundness, because higher levels of capital are likely to reduce the probability of failure and provide greater protection to deposit insurers.

Because credit unions currently do not have access to supplemental capital, they may be required to endure long periods in which they charge high loan rates, pay low rates on deposits, cut costs (and thus services to members), and are far less attractive to their members in order to preserve their regulatory capital ratios. These credit unions are faced with the unpalatable choice of strengthening their capital position quickly or providing good service to their members. A sufficiently large reduction in its capital ratio, then, might entail services and deposit and loan rates so unattractive to its members that the credit union would be unlikely to recover from otherwise survivable challenges. Access to supplemental capital would provide an effective tool for healthy credit unions to enhance safety and soundness and expand services and credit to their members. By ensuring that institutions can remain attractive as they rebuild their capital, access to supplemental capital would likely reduce the number of troubled institutions that actually failed and reduce the costs imposed on deposit insurers.

IV. Congress should delegate to NCUA authority to determine capital requirements.

As discussed previously, Congress currently delegates to federal banking regulators the authority to set, by regulation, nearly all the detail in the structure of bank capital requirements, ranging from what may count as capital to nearly all the numerical values in those requirements.[29] With CUMAA, Congress set by statute nearly all the key details of the structure of credit union capital requirements.[30] Therefore, in light of the inevitable, but unpredictable changes in conditions, federal bank regulators can readily update bank capital requirements. In contrast, the NCUA cannot.

In these circumstances, credit unions often find that making necessary adjustments to their capital requirements, small or large, is needlessly slow, complex, and uncertain. By delegating to federal bank regulators the authority to update key details in bank capital requirements, but not delegating similar authority for credit unions, Congress finds that it does not have to update legislation on bank capital requirements very often, but it does have to revisit many details of credit union capital requirements regularly. For example, changes in generally accepted accounting principles (GAAP) regarding the treatment of mergers recently required Congress to adjust capital requirements so that the continuing credit union in a merger could count as capital both its retained earnings and the retained earnings (which GAAP had reclassified as acquired equity) in the merging credit union.[31] Similarly, on January 4, 2011, a law was enacted which allows credit unions to count assistance to avoid liquidation toward their capital requirements.[32]

The goals, tradeoffs, and issues involved in capital requirements for both commercial banks and credit unions are broadly similar. Thus, Congress should structure capital

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[29] 12 U.S.C. 1831o(b)((2)(G) states "the term 'required minimum level' means, with respect to each relevant capital measure, the minimum acceptable capital level specified by the appropriate federal banking agency by regulation."
[30] Capital requirements for both commercial banks and credit unions include some elements that Congress set by statute and some elements that regulators set by regulation. However, the legislated elements for commercial banks are very limited, including tangible equity worth 2% of total assets. In contrast, the legislated elements for credit unions are very extensive, including a schedule of net worth requirements ranging from 2% of total assets for critically undercapitalized institutions to 7% of total assets for well capitalized institutions. Both commercial banks and credit unions have additional sets of risk-based capital requirements that regulators set by regulation. However, since the legislated requirements per total assets are much lower for commercial banks and much higher for credit unions, the risk-based requirements are the main binding constraint for most commercial banks and the requirements per total assets are the main binding constraint for most credit unions.
[31] Financial Services Regulatory Relief Act of 2006 (Public law 109-351).
[32] Public law 111-382.

requirements for both sets of institutions so that, when various conditions inevitably and importantly change unexpectedly, capital requirements can be adjusted readily and appropriately. The extent to which Congress sets capital requirements in statute and delegates authority to federal regulators should be broadly similar for banks and for credit unions.

Thus, Congress should set in statute the broad outline of credit union capital requirements and delegate to the NCUA the authority to set and update, by regulation, the details of those requirements.[33] Moreover, by delegating authority to the NCUA now, Congress would not forgo its ability to correct or restrain the NCUA in the future. For instance, Congress recently updated the contours of the authority granted to federal bank regulators.[34]

If Congress delegated the authority, the NCUA could set and update, by regulation, what counts as capital for credit unions. Using such authorization, the NCUA should permit by rule credit unions to use various capital instruments to meet their capital requirements. Individual credit unions could, then, raise capital externally to respond, as needed, to various changes in conditions, ranging from recessions and loan losses to inflows of deposits and loan opportunities. Thus, Congress could aid credit unions' efforts to serve their members, their communities, and to assist the economic recovery.

[33] In letters to the leaders of the House Financial Services Committee and the Senate Banking Committee, NCUA Chairman Debbie Matz recently presented similar but more limited proposals to exclude government securities from assets in the denominator of the net worth ratio and to allow capital instruments in the numerator of the net worth ratio. Excluding government securities from the net worth ratio would help credit unions to accommodate deposit inflows during and after recessions and harks back to earlier structures of credit union capital requirements, such as those between 1970-1998 when some requirements were based on risk-based assets (largely loans). The NCUA also released its Supplemental Capital White Paper in April 2010 presenting possible approaches. The White Paper, prepared by an internal NCUA working group and led by NCUA Board Member Gigi Hyland, reviews NCUA's current authority, offers three possible models for supplemental capital, and provides modeling and suggested statutory revisions. NCUA. 2010. "Supplemental Capital White Paper." Alexandria, VA.

[34] Through section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public law 111-203), Congress required federal bank regulators to apply the same capital requirements to banks and to their BHCs. In effect, this change forbid larger banks from counting trust preferred securities (a hybrid instrument combining some characteristics of subordinated debt and of preferred stock) toward bank core (Tier 1) capital requirements. Section 616 also requires federal bank regulators to seek that capital requirements be countercyclical.

A. Examples: Illustrating the implications.

Figure 7 further highlights the importance of being able to raise supplemental capital during troubled times. Since the onset of the financial crisis, reported commercial bank capital ratios were strengthened by massive injections of new capital, from both the private and public sectors. Had they received such injections, credit unions could have avoided declines, and perhaps even increased, their capital ratios. Capital injections would, regardless of their net effects on capital ratios, have likely boosted the deposits and loans that credit unions would have supplied to the benefit of their members, of their communities, and of the economy more broadly.

More specifically, Figure 7 compares actual capital-to-asset ratios for credit unions and commercial banks during 1987-2010Q3, as well as two hypothetical cases. The actual capital ratio for commercial banks barely declined during the crisis, falling from 10.23% in 2007 to 9.38% in 2008, and has even grown steadily since then reaching 11.40% in 2010. In contrast, the actual capital ratio for credit unions declined markedly from 11.29% in 2007 to 9.77% in 2009. Combined with Figure 5 (on loan growth), this figure highlights the potential impact on lending due to small changes in average capital-to-asset ratios, even if the averages are well above required regulatory minimums. Loan growth may decline substantially for several reasons. Small changes in average capital ratios may mask large declines for individual institutions that become deeply constrained. A high average capital ratio may also mask far lower capital ratios among faster-growing institutions that may have delivered outsized fractions of loan growth. Further, lending decisions may not respond solely to actual declines in capital but to the uncertainty of how large those declines may become.

Figure 7
Credit Union and Commercial Bank Capital to Asset Ratios:
Actuals in 1987-2010Q3 and Two Hypotheticals,
For Credit Unions: Adding Commercial Banks' Capital Raisings in 2008-2010Q3
For Commercial Banks: Subtracting their Capital Raisings in 2008-2010Q3
(%, annual, 1987-2010Q3, CUNA, FDIC)

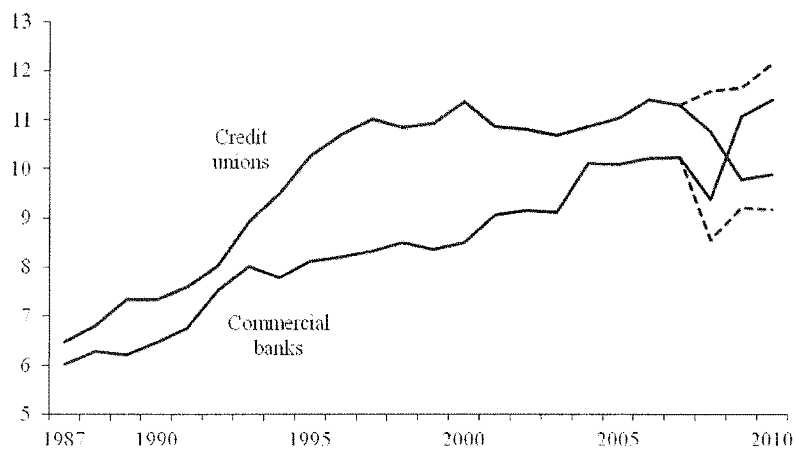

Figure 7 also includes a hypothetical case for commercial banks, assuming that they were not able to raise capital externally in 2008-2010. In such circumstances, their capital ratio would have fallen to 8.55% in 2008 and would have barely recovered since. The hypothetical case for credit unions assumes that they would have raised the same amount of supplemental capital (per assets) as banks did during 2008-2010. In this hypothetical, credit union capital ratios would not have fallen and would have reached 12.12% by 2010.

These hypotheticals are not predictions, but rather highlight the implications of being able to raise capital externally. If commercial banks had not been able to raise capital externally, they would likely have raised more capital internally by charging higher rates on loans, paying even lower rates on deposits, and, thus, retaining more earnings. If credit unions had been able to raise capital externally, they might have raised less capital internally, by charging lower rates on loans, paying higher rates on deposits, and, thus, retaining fewer earnings.

Similarly, credit unions would likely not have sought to increase their capital ratios but, rather, accepted more deposits and made more loans, such that their capital ratios remained constant. In a simple projection, had credit unions been permitted access to supplemental capital in the same amount (per assets) as commercial banks and credit unions had sought to maintain their capital ratio at their 2008 level, they could have expanded their lending by an additional \$37 billion in 2008-2010.[35] Under such a projection, instead of cutting their inflation-adjusted loan growth by -3.34% in 2010, credit unions would have increased it by 1.24%, in line with their traditional practice of counterbalancing declines in commercial bank lending during recessions.

V. Specific issues must be considered in regulating capital instruments.

Expanding eligible capital instruments for credit unions must be carefully considered. Some of the considerations that should inform NCUA regulation of capital instruments are well recognized. In general, depositories, their regulators, their insurers, their customers, and taxpayers all benefit when depositories can raise capital quickly and in large amounts. Depository institutions with more capital are less likely to fail. Even if they do fail, institutions that used capital instruments to bolster their cushions before they became troubled are likely to impose lower costs on deposit insurers.

Other considerations regarding expanded capital instruments for credit unions include:

- <u>Credit union capital instruments should be consistent with their cooperative structure</u>. Holders of credit union capital instruments should not gain more votes or control

[35] Credit union loans in 2010Q3 would total \$615 billion instead of the actual \$578 billion, or 6.5% more. While this difference may not be large from the point of view of the economy as a whole, it does highlight that while a small player in the market of depository institutions, credit unions can play a countercyclical macroeconomic role.

beyond what they would otherwise have as regular members with a single vote per member in elections to credit unions' Boards of Directors.

- Capital instruments should place funds at risk. The claims of their owners should not be insured as deposits and should be subordinated to the claims (1) of all regular depositors and (2) of the depositor insurer.
- Capital instruments should be long-term in nature. Common minimum maturities are 10 years, with the fraction of instruments that count as capital being reduced as an instrument's maturity reaches 1-5 years remaining.[36]
- Credit unions should not be required to use any capital instruments beyond retained earnings. Like banks, credit unions should be permitted to meet all their capital requirements with retained earnings. Credit unions should be permitted to use other capital instruments to meet part of their requirements, but not required to use them.
- The NCUA, like federal bank regulators, should update its credit union capital requirements periodically as conditions warrant. These updates may change required capital levels, the factors and formulas that help determine those levels, and the types and characteristics of permitted capital instruments.

However, even while the NCUA exercises strong regulatory oversight over emerging capital instruments, the NCUA and individual credit unions will face several important choices about the regulation and use of capital instruments. These choices include:

- What specific capital instruments to permit? Options range from (1) more equity-like instruments without maturity dates and with adjustable rates to (2) more debt-like

[36] Some items that may be counted as core or supplemental capital are not instruments that are issued, but various reserves ranging from, of course, retained earnings, but also the allowance for loan losses.

instruments with preset maturity dates and preset rates. Whatever the instrument, it is important to note that it would be highly regulated.

- How should capital instruments be issued? Options range from (1) making them available to regular members at the credit union to (2) making them available to credit union-related entities (e.g., other highly-capitalized natural person credit unions, corporate credit unions, CUNA Mutual, etc.), (3) making them available to all investors through brokerages, or (4) making them available to qualified or institutional investors (e.g., pension funds, insurance companies, mutual funds, ETFs specialized in the hybrid capital instruments of depository institutions). The tradeoffs involved in these choices range from the size of the potential market to the rates credit unions would have to offer, the speed with which capital could be raised in normal or troubled times, and the protection of less well informed savers. To enforce this last goal, the NCUA could require credit unions to apply suitability requirements before it issues some types of capital instruments to retail savers.

In its 2004 report, GAO also suggested that credit unions did not have a consensus on whether capital requirements should be reformed or what shape that reform should take. This paper is not advocating a one-size-fits-all approach. We recognize, however, that collectively credit unions would benefit from the ability to use capital instruments even if credit unions' use of capital instruments would likely vary widely. Some credit unions may use them regularly. Others may never use them. Yet others may use them occasionally. Many will simply use them as conditions change, raising capital during and after recessions to accommodate inflows of deposits, to be able to maintain their lending, or to offset loan losses. This variety underscores the need for empowering the NCUA with the authority to develop appropriate regulations.

VI. Conclusions

Capital requirements for credit unions must be adjusted to respond to fundamental changes in the financial landscape. Current credit union capital requirements restrict credit unions' ability both to act as safe harbors for depositors and to reduce the pro-cyclicality of total lending. Recent experience confirms that the structure of capital requirements can greatly affect credit unions' ability in assisting recovery. The recession of 2007-2009 involved large increases in provisions for loan losses and declines in capital for many depository institutions. While commercial banks again restricted deposit and loan growth far more than credit unions, declines in capital ratios forced credit unions to limit or forgo their traditional countercyclical role. Reaching -3% by 2010, growth rates in inflation-adjusted credit union lending fell 8% below rates consistent with long-term economic growth. With better access to capital, not only could the safety and soundness of credit unions be enhanced, but they would be positioned to offset the reduction in bank lending that has contributed to past recessions and slowed the current economic recovery.

Accordingly, Congress should provide the NCUA with the authority to determine capital requirements for credit unions and to update them as appropriate. These changes would parallel existing authorities of the other federal financial regulators. Empowering the NCUA to develop appropriate capital requirements for credit unions would also promote three important policy objectives:

- Expanded capital authority for credit unions would promote the safety and soundness of the credit union system;

- Expanded capital authority would allow credit unions to enhance their ability to serve their members (increased deposits and lending) and improve the efficiency of their operations; and
- Expanded capital authority for credit unions would benefit the broader economy and help speed up the economic recovery.

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October 11, 2011

The Honorable Shelly Moore Capito
Chairman, Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
2443 Rayburn House Office Building
Washington, DC 20515

The Honorable Carolyn Maloney
Ranking Member, Subcommittee on Financial Institutions and Consumer Credit
United States House of Representatives
2332 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Capito and Ranking Member Maloney:

On behalf of the 1.1 million members of the National Association of REALTORS® (NAR), and its commercial affiliates*, and in anticipation of tomorrow's hearing on "H.R. 1418: The Small Business Lending Enhancement Act of 2011," I respectfully request your support of H.R. 1418, the "Small Business Lending Enhancement Act of 2011," introduced by Representative Royce (R-CA). This legislation will increase the cap on member business lending (MBL) from 12.25% to 27.5% of total assets for well-capitalized credit unions, and allow these community-focused institutions to play a more significant role in rejuvenating our nation's economy.

Nearly $1.2 trillion of commercial real estate loans with balloon mortgages will mature over the next few years, with very limited options to refinance. If not addressed, the swelling wave of maturities could place further stress on our nation's already fragile financial markets and overall economy. H.R. 1418 will create a new source of capital to refinance these commercial loans, and help to prevent the commercial real estate sector from holding back the nation's economic recovery.

The bill will also have benefits beyond the commercial real estate sector, increasing access to desperately needed capital for the small businesses that employ nearly half of all Americans and account for 60% of U.S. job creation. Lending to small businesses declined by $43 billion last year and 64% of small businesses with less than $1 million in revenue that applied for loans in the past 12 months were rejected by banks.

NAR believes credit unions have the ability to help fill the commercial real estate and small business lending gap. If H.R. 1418 is signed into law, the Credit Union National Association estimates that credit unions could lend an additional $13 billion to businesses in the first year after implementation, helping to create 140,000 new jobs. Moreover, this bill will not cost the U.S. taxpayer a single dime or increase the size of government.

In order to help improve lending conditions and spur job growth, NAR urges passage of this important legislation.

Sincerely,

Ron Phipps, ABR, CRS, GRI, GREEN, e-PRO, SFR
2011 President, National Association of REALTORS®

cc: Members, House Subcommittee on Financial Institutions and Consumer Credit

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Congressional Research Service

Should Credit Unions Be Taxed?

James M. Bickley
Specialist in Public Finance

September 8, 2010

Congressional Research Service
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97-548

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

Credit unions are financial cooperatives organized by people with a common bond; they are the only depository institutions exempt from the federal corporate income tax. As financial cooperatives, credit unions only accept deposits of members and make loans only to members, other credit unions, or credit union organizations. Many Members of Congress advocate a reliance on market forces rather than tax policy to allocate resources. Furthermore, some Members of Congress are interested in additional sources of revenue in order to either reduce the deficit, offset the cost of higher federal outlays, or make up for tax cuts elsewhere. Consequently, the exemption of credit unions from federal income taxes has been questioned. If this exemption were repealed, both federally chartered and state-chartered credit unions would become liable for payment of federal corporate income taxes on their retained earnings but not on earnings distributed to depositors. For FY2010 (October 1, 2009, through September 30, 2010), the Joint Committee on Taxation estimates that federal taxation of credit unions would yield revenue of approximately $1.6 billion.

Credit unions differ in some aspects from other providers of financial services, but financial deregulation continues to lessen these differences. Deregulation has resulted from new legislation and decisions of regulatory agencies. Proponents of the taxation of credit unions argue that deregulation has led to vigorous competition between credit unions and other depository institutions. They maintain that the tax exemption gives credit unions an unfair competitive advantage over other depository institutions, and there is no market failure that justifies government intervention with a tax subsidy. Supporters of the tax exemption claim that, despite deregulation, credit unions are still unique depository institutions. They assert that the purpose of credit unions is to serve the financial needs of their members rather than to maximize profits. They argue that taxation would eliminate this service character of credit unions.

In the 111th Congress, no legislation specifying the elimination or curtailment of the tax-exempt status of credit unions has been introduced. In the 111th Congress, legislation has been introduced to expand credit unions' ability to make business loans. Banking trade associations argue that the proposed expansion of credit unions' lending authority further reduces the distinction between banks and credit unions, and consequently, lessens the justification for the tax-exempt status of credit unions.

On August 27, 2010, the President's Economic Recovery Advisory Board (PERAB) released *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation.* For corporate tax reform, PERAB presented the option of broadening the corporate tax base and reducing marginal corporate income tax rates. According to PERAB, an option to broaden the corporate tax base would be to eliminate or reduce tax expenditures including the exemption of credit union income from tax.

In the future, technological change and regulatory changes may further increase competition between credit unions and other depository institutions. The income tax exemption for credit unions, therefore, may be the subject of further debate.

This report will be updated in the event of significant legislative activity or policy proposals.

Contents

Appendixes

Contacts

Credit unions are the only depository institutions exempt from the federal income tax.[1] Deregulation is reducing the unique character of credit unions. Many Members of Congress advocate a reliance on market forces rather than tax policy to allocate resources. Furthermore, some Members of Congress are interested in additional sources of revenue in order to either reduce the deficit, or offset the cost of either higher federal outlays or other tax cuts. Consequently, the exemption of credit unions from federal income taxes has been questioned. If this exemption were repealed, both federally chartered and state-chartered credit unions would become liable for payment of federal corporate income taxes on their retained earnings but not on earnings distributed to depositors. For FY2010 (October 1, 2009, through September 30, 2010), the Joint Committee on Taxation estimates that taxing credit unions would yield approximately $1.6 billion.[2] The issue of the business income tax exemption of credit unions is examined in this report by covering the following topics: concept of a credit union, tax status, deregulation, arguments for and against taxation, congressional debate in the 111th Congress and trends in the finance industry. Congressional debate in the 108th through the 110th Congresses is presented in the **Appendix**.

Concept of a Credit Union

A credit union is a nonprofit financial cooperative organized by people with a common bond. As financial cooperatives, credit unions only accept deposits of members and make loans only to members, other credit unions, and credit union organizations.[3] A common bond is a unifying characteristic among members that distinguishes them from the general public. Every member of a credit union is an owner and may vote for credit union officers and policies. Credit unions do not have separate capital stock; instead their capital consists of their members' shares in accumulated reserves.[4] Credit unions cannot raise capital by issuing stock but utilize retained earnings to finance expansion. Credit unions are either federally chartered or state-chartered. Each credit union is governed by a board of directors. The board exercises general supervision over all functional areas including membership and credit applications, interest rate policies, and records.[5] According to the Garn-St. Germaine Depository Institutions Act of 1982,

> The management of a Federal credit union shall be by a board of directors, a supervisory committee, and where the bylaws so provide, a credit committee.
>
> The supervisory committee shall be appointed by the board of directors....
>
> At their first meeting after the annual meeting of the members, the directors shall elect from their number the board officers specified in the bylaws.[6]

---

[1] All credit unions collect federal payroll taxes. Federally-chartered and state-chartered credit unions are subject to local property taxes. State chartered-credit unions may be subject to additional state and local taxes.

[2] U.S. Congress, Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2009-2013*, January 11, 2010 (JCS-1-10), p. 36.

[3] Richard P. Kessler, Jr. "Credit Unions in the 1990s," *Consumer Finance Law*, vol. 47, no. 1, winter 1993, p. 4.

[4] Ibid.

[5] Olin S. Pugh and F. Jerry Ingram, *Credit Unions: A Movement Becomes an Industry* (Reston, Virginia, Reston Publishing Company, Inc., 1984), p. 7.

[6] P.L. 97-320, Sec. 111 and 112.

At the end of 2009, the 7,708 credit unions had 91.16 million members and total assets of $896.8 billion.[7] Thus credit unions had an average of $116.3 million in assets. Although most credit unions are small, some are large. For year end 2008, 134 credit unions had assets of $1 billion or more, and these credit unions had total assets of $337 billion.[8]

Among depository financial institutions, the concept of a common bond is unique to credit unions. In 1970, the National Credit Union Administration (NCUA) was established by the federal government to regulate the federal credit unions. The NCUA has specified four categories of common bonds: single occupational, single associational, multiple common bond, and community. Credit union members in the *single occupational* category are employed by the same enterprise, such as the ABC corporation. A credit union in this category may also serve a trade, industry, or profession, such as all teachers. Members of a *single associational* category belong to groups of individuals who participate in activities that develop common loyalties, mutual benefits, and mutual interests, such as the Knights of Columbus. A single associational group must sponsor activities providing for contact among members. A credit union with a *multiple common bond* consists of a combination of occupational and/or associational groups. Members in the *community* category have a common bond based on employment or residence in a geographic area with clearly defined boundaries.[9]

In the late 1970s and early 1980s, serious economic dislocations threatened the financial stability of many federal credit unions.[10] Hence, beginning in 1982, the National Credit Union Administration made a series of administrative rulings that allowed multiple-group federal credit unions; that is, combinations of existing federal credit unions that do not share a common bond.

In 1990, the American Bankers Association and several small North Carolina banks filed a lawsuit (NCUA v. First National Bank & Trust Co.,[11] et al.) challenging the NCUA's approval of a multiple-group field of membership expansion for federal credit unions. On February 25, 1997, the United States Supreme Court, at the urging of the Clinton Administration, agreed to hear arguments in the case.

On February 25, 1998, the U.S. Supreme Court ruled in favor of the banking industry. Legislation was introduced to address the concerns of the credit union industry. On August 7, 1998, the Credit Union Membership Access Act (P.L. 105-219) was enacted. The act grandfathered all current federal credit unions (FCUs) and all current credit union members and provided for future multiple-group formations subject to limitations that the NCUA must consider when authorizing charters.[12]

Regulatory modernization legislation for credit unions, the Credit Union Regulatory Improvements Act (CURIA), was introduced in both the House and Senate in the 110th Congress.

[7] Credit Union National Association, *U.S. Credit Union Profile*, March 7, 2010, p. 9.

[8] Credit Union National Association, *Credit Union Report Mid-Year* 2008, June 2008, p. 10.

[9] National Credit Union Administration, *Chartering and Field of Membership Manual* (Washington, March 2003), pp. 18-19.

[10] In the late 1970s and early 1980s, the U.S. Government provided no financial assistance to the credit union industry. In contrast, the cleanup costs of the thrift industry in the 1980s and early 1990s was $124 billion according to Federal Deposit Insurance Corporation (FDIC).

[11] 522 US 479 (1998).

[12] CRS Report 98-933, *Credit Union Membership Access Act: Background and Issues*, by Pauline Smale, p. 1. This report is available on request from the author.

On March 15, 2007, H.R. 1537 (CURIA 2007) was introduced in the House, and on May 1, 2008, S. 2957 (CURIA 2008) was introduced in the Senate. These identical bills proposed to modernize capital requirements, raise the cap on member business lending, enhance the ability of credit unions to serve financially underserved areas, and provide regulatory relief.[13] The legislation was not enacted.

In the 111th Congress, two proposed bills would expand credit unions' ability to make business loans: America's Small Businesses Act of 2009 (H.R. 3380) and the Small Business Lending Enhancement Act of 2009 (S. 2919).[14] The banking industry generally opposes these bills.

Tax Treatment of Credit Unions

The first credit union in the United States was state chartered in 1909. When the federal income tax was enacted, state chartered credit unions were not specifically exempt. In 1917 an administrative ruling by the U.S. Attorney General exempted state chartered credit unions from federal income taxation.[15] In 1934, Congress passed the Federal Credit Union Act, which authorized the chartering of federal credit unions. This act contained no federal tax exemption and allowed states to tax federal credit unions in the same manner as banks. In 1937, Congress amended the act to exempt federal credit unions from both federal and state income taxes because of their service to members.[16] Until 1951, all savings and loans (S&Ls) were exempt from federal income taxes under the same tax code provision. The Revenue Act of 1951 repealed the tax exemption for S&Ls, but the exemption for federal and state credit unions was continued under a separate tax code provision.[17] But Congress provided S&Ls a *de facto* exemption from federal income taxes by permitting a liberal allowance for bad debt reserves. This *de facto* exemption continued until the Revenue Act of 1962, which reduced the liberal allowance for bad debt reserves.[18]

Federally chartered credit unions are exempt from all taxes (including income taxes) imposed by any state, territorial, or local taxing authority, except for local real or personal property taxes.[19] States vary in their tax treatment of state-chartered credit unions. A few states exempt state-chartered credit unions from their state income taxes. Many states tax state-chartered credit unions the same as state-chartered thrifts, and several states tax state-chartered credit unions the same as any other business.[20]

[13] For an explanation of the contents of this legislation, see archived CRS Report RS22661, *Credit Union Regulatory Improvements Act (CURIA): H.R. 1537 and S. 2957*, by Pauline Smale.

[14] For a comprehensive examination of this legislation, see CRS Report R40793, *Credit Union Member Business Loans*, by Pauline Smale.

[15] U.S. Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions* (Washington, January 15, 2001), p. 28.

[16] "The Tax Exemption Through the Ages," *Credit Union*, January1986, p. 9.

[17] U.S. Congress, Joint Committee on Taxation, (Prepared for use of the Committee on Ways and Means and the Committee on Finance), *Tax Reform Proposals: Taxation of Financial Institutions* (Washington: GPO, 1985), p. 43.

[18] Kenneth R. Biederman and John A. Tuccillo, *Taxation and Regulation of the Savings and Loan Industry* (Lexington, MA: Lexington Books, 1976), p. 5.

[19] National Credit Union Administration, *Letter of Exemption*, Alexandria, Va., revised May 2003.

[20] Pugh, pp. 51-52.

Before the passage of the Tax Reform Act of 1986, numerous specific tax preferences were given to depository institutions (except credit unions, which were and are exempt). The primary justification for these tax preferences was the extensive regulations imposed on depository institutions. These tax preferences reduced the effective tax rate on operations of depository institutions below the effective tax rate on operations of average U.S. corporate businesses.

Proponents of the Tax Reform Act of 1986 contended that the tax system should be neutral concerning economic decision making. They believed that the market forces of supply and demand could more efficiently allocate resources than the tax system; consequently, tax preferences for specific industries or sectors should be eliminated or curtailed. They argued that the elimination or reduction of tax preferences would broaden the tax base and permit lower marginal tax rates; therefore, economic resources would be allocated more efficiently. Financial deregulation had been reducing both the differences among depository institutions and between depository institutions and other industries. Thus, tax preferences for depository institutions were more difficult to justify if the tax system was to be more neutral and resources were to be allocated by market forces rather than federal regulations. Consequently, the Tax Reform Act of 1986 curtailed or eliminated tax preferences of depository institutions. The three most important of these tax preferences were deductions for additions to bad debt reserves, the deduction for interest to carry tax exempt obligations, and special rules for net operating losses. The more neutral federal tax system heightened criticism of the tax exemption of credit unions.

Tax Comparison with Other Firms

How does credit union taxation compare with that of other firms in economic terms? For a typical corporation, income taxes are paid on income from equity-financed investment whether retained or paid in dividends. Shareholders (equity owners) pay individual income taxes on dividends and capital gains taxes on the nominal appreciation (if any) in the value of their stock in the year that the stock is sold. Income from debt financed investment is tax exempt at the corporate level; interest paid on bonds is a deductible expense to the corporation but taxable income to bondholders. Most corporate equity investment is thus taxed twice, debt once.

Commercial banks and thrift institutions are taxed like other corporations except for the tax treatment of depositors. In compensation for their deposits, depositors receive a mix of interest payments and free or below cost services. Interest payments received by depositors are subject to the individual income tax. Free or below cost services are not subject to the individual income tax, but the cost of providing these services are expenses to the commercial bank or thrift. Since it is not administratively feasible to allocate the reduced cost of financial services among depositors, it is not possible to levy income taxes on these services.[21] Thus, at least part of banks' income from debt is exempt from both corporate and individual tax. Bank equity income is taxed twice; debt once, at the most.

Income of credit unions is exempt at the corporate level, whether retained or distributed. And as with banks, a portion of the income distributed to members in compensation for their deposits, called member "dividends," is subject to individual income tax, while the portion distributed as enhanced member services is not taxed. Thus, in contrast to corporations—including corporate banks—no credit union income is taxed twice; credit union income is taxed once, at the most,

[21] Most developed nations with value-added taxes exclude financial services from taxation because it is not administratively practicable to measure value-added received by customers.

under the individual income tax. Taxing credit unions in a manner similar to corporate banks would require, at least, applying corporate tax to retained credit union earnings.[22]

Since 1997, banks and thrifts have been eligible to incorporate as or convert to S corporations.

> An S corporation is a closely held corporation that elects to be treated as a pass-through entity for tax purposes. S corporations are named for Subchapter S of the IRC, which details their tax treatment. By electing S corporation status, a business is able to combine many of the legal and business advantages of a C corporation with the tax advantages of a partnership.
>
> S corporations generally do not pay income taxes. As with partnerships, operating income and loss are computed at the corporate level and passed through to the shareholders.[23]

In order for a bank to be eligible to incorporate as or convert to an S corporation, numerous restrictive rules and conditions must be met. Even if eligible, a bank may not find it advantageous to convert.[24] The Credit Union National Association (CUNA) takes the position that

> The banking industry's efforts to impose additional taxes on credit unions while aggressively lobbying to increase the tax advantages of Subchapter S for banks is hypocritical. However, CUNA does not oppose the efforts of the banking industry to expand its tax benefits.[25]

Finally, this discussion of financial institutions has thus far omitted the tax treatment of another type of financial intermediary: life insurance companies.[26] Life insurance companies receive special treatment under the corporate income tax; they are subject to a low level of tax compared to other financial intermediaries (excepting, of course, credit unions). Further, the earnings of depositors (i.e., policyholders) are lightly taxed under the individual income tax because the inside buildup—growth of cash values—on insurance policies is not subject to tax.

Deregulation

Over the past 30 years, most of the distinctions between credit unions and other depository institutions have been eliminated or reduced because of deregulation; consequently, the justification for the tax exemption for credit unions has been increasingly questioned.

Proponents of deregulation argue that resources can usually be more efficiently allocated by market forces than government regulations. They do not advocate the elimination of all

[22] In theory, it might be argued that since members are also equity owners of credit unions, a portion of income and benefits accruing to stockholders is actually distributed credit union equity-like earnings, and simply taxing retained earnings would apply tax to only a part of income from equity-like investment. However, it is not administratively feasible to assess the value of these distributed equity-like benefits, and proposals to tax credit unions have been limited to applying the corporate income tax to retained earnings.

[23] CRS Report R40748, *Business Organizational Choices: Taxation and Responses to Legislative Changes*, by Mark P. Keightley.

[24] For an examination of these rules and conditions, see Mark R. Baran, *Should You Bank on Subchapter S?* American Bankers Association, 1997, 9 pp.

[25] Credit Union National Association, *Subchapter S Corporation Banks*, August 27, 2009, p. 4.

[26] For an overview of the taxation of life insurance, see archived CRS Report RL32000, *Taxation of Life Insurance Products: Background and Issues*, by Andrew D. Pike (consultant).

regulations but rather a greater reliance on market forces. Proponents maintain that deregulation increases competition, which benefits customers through better access to services at lower prices. Furthermore, deregulation leads to more integrated financial markets, which improves national economic efficiency. Both federally-chartered and state-chartered credit unions have been deregulated as discussed in the following section. The discretionary powers of state-chartered credit unions compared with those of federally-chartered credit unions vary among states.

Deregulation can be divided into price, geographic, and product deregulation. *Price deregulation* concerns the loosening or elimination of restrictions on interest rates that depository institutions may pay on supplies of funds and charge on loans. Price deregulation has caused credit to be rationed more by price than by availability. Many individual savers benefitted from price deregulation because they could earn higher interest rates on their deposits.

Geographic deregulation has been particularly important to commercial banks and bank holding companies, which were prevented by federal and state banking laws from offering full service interstate banking. The Office of the Comptroller of the Currency made rules that have expanded intrastate bank branching. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (P.L. 103-328) authorized nationwide interstate banking through the holding company format effective September 29, 1995. Effective June 1, 1997, under this law, the federal bank regulatory agencies may approve mergers between banks in different states unless the home state of one of the banking institutions has opted out by enacting a law explicitly prohibiting merger transactions involving out-of-state banks that applies equally to all out-of-state banks.[27]

In 1991, the National Credit Union Administration permitted credit unions to share branches, thus giving them an inexpensive way of expanding their geographic coverage.[28] In May 1992, the Office of Thrift Supervision permitted nationwide branching by all thrift institutions.[29]

But credit unions still have some restrictions on branching. For example, a federal credit union may not establish a new branch office for the purpose of adding a group [combining with another credit union through a multiple-group charter].[30]

Product deregulation is blurring the distinctions among products offered by different types of depository institutions (e.g., checking accounts, credit cards, mortgages, etc.). Product deregulation has been accelerated by the mergers of some large financial and nonfinancial firms. Also, many firms have found methods of circumventing existing laws in order to offer additional financial products. The enactment of the Gramm-Leach-Bliley Act (P.L. 106-102) in 1999 facilitated affiliation among banks, securities firms, and insurance companies, permitting financial conglomerates to cross-sell a variety of financial products to their customers (one-stop shopping). This act also allowed national and state banks to create financial subsidiaries for diversification into insurance sales and full-service securities activities under specified

[27] CRS Report 94-744, *The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994*, by M. Maureen Murphy, pp. 1-2. This report is out of print but available upon request from the author.

[28] Dean F. Amel, "Trends in the Structure of Federally Insured Depository Institutions, 1984-94," *Federal Reserve Bulletin*, vol. 82, no. 1, January 1996, p. 4.

[29] Ibid.

[30] Kessler, p. 10.

conditions. In addition, this act permitted banking ("financial holding") companies to invest in nonfinancial businesses for a share of the profits.[31]

Deregulation has resulted in the rapid expansion of most services offered by credit unions. Larger credit unions tend to offer a wider range of services than smaller credit unions. Deregulation has been implemented by legislation and rulings by the National Credit Union Administration. But credit unions, compared to other depository institutions, still have restrictions on their powers to lend and invest funds. For example, the Credit Union Membership Access Act (P.L. 105-219) limits business loans to members to 12.25% of total assets.[32] Also, credit unions may only "extend lines of credit to their members, to other credit unions, and to credit union organizations."[33]

The Treasury compared the basic statutory and regulatory rules applied to depository institutions across four broad categories: institution powers, safety and soundness, regulatory enforcement authority, and consumer protection. The Treasury concluded that

> Federal credit unions generally operate within the same legal framework as other federally insured depository institutions. Most differences between credit unions and other depository institutions derive from the structure of credit unions. We found this to be most likely in the case of safety and soundness rules, where credit union operations interact directly with the operation of the rules. With regard to enforcement and consumer protection rules, few differences exist. Credit unions have fewer powers available to them than do banks and thrifts, but through CUSOs [credit union service organization], credit unions may provide their members with a panoply of sophisticated financial services and products that rivals the offerings of banks and thrifts.[34]

Arguments For and Against Taxation

Proponents of taxation of credit unions argue that deregulation has caused extensive competition among depository institutions. These institutions actively compete for deposits by offering the best terms, including the highest rate of return to depositors. Depository institutions also compete for borrowers by offering the best loan terms including the lowest interest rates. Proponents of taxation argue that the concept of the common bond has continued to weaken. For example, the OmniAmerican Federal Credit Union

> ... counts 137,000 members employed at 1,300 businesses and organizations, ranging from the Boy Scouts of America to Pier One Imports. At the end of 1996, assets totaled $517 million.... [35]

Another example, the "Wescom Credit Union's field of membership includes the 16 million people living in Los Angeles, Ventura, Orange, Riverside, and San Bernardino Counties."[36]

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[31] CRS Report RS21134, *Merchant Banking: Mixing Banking and Commerce Under the Gramm-Leach-Bliley Act*, by Gary Shorter.

[32] CRS Report 98-933, *Credit Union Membership Access Act: Background and Issues*, p. 3.

[33] Kessler, p. 5.

[34] U.S. Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions*, p. 24.

[35] Kenneth N. Gilpin, "Piggy Banks with Muscles," *New York Times*, vol. 146, no. 50,715; February 26, 1997, p. B1.

[36] *Testimony of Jeff Plagge on behalf of the American Bankers Association before the Committee on Ways and Means*, (continued...)

Tax proponents maintain that vigorous competition between credit unions and other depository institutions justifies the same tax treatment for all institutions. They argue that, for market forces to allocate resources efficiently, depository institutions should have a level playing field. But, in this view, the income tax exemption for credit unions gives them a competitive advantage over other depository institutions. Credit unions pay no income taxes on earnings whether distributed or retained. Credit unions can earn tax free interest on their retained earnings. Proponents assert that credit unions have lower operating costs because of their tax exemption. Consequently, credit unions can pay depositors higher rates of return and charge borrowers lower interest rates. It can be argued that the income tax exemption for credit unions has enabled them to grow more rapidly than other depository institutions.

The American Bankers Association (ABA) states that, "Traditionally, credit unions were based on a simple concept: bring together a closely-knit group of people, pool their resources, and provide small loans for one another."[37] The ABA argues that the tax exemption has allowed some of these traditional credit unions to "morph" into "highly competitive financial institutions virtually indistinguishable from banks."[38] The ABA maintains that "credit unions that have adhered to the traditional principles should continue to benefit from the tax preferences."[39] But, the ABA argues that credit unions that have morphed into large, aggressive financial institutions should lose their tax exemption.[40]

Supporters of the credit union tax exemption emphasize the uniqueness of credit unions compared to other depository institutions. Credit unions are nonprofit financial cooperatives directed by volunteers for the purpose of serving their members. Credit unions provide many services free or below cost in order to assist members. These services include small loans, financial counseling, and low balance share drafts. The NCUA argues that the taxation of credit unions would create pressure to eliminate these subsidized services. Furthermore, taxing credit unions would raise the cost of credit to many people without an alternative source of credit. Concern has been expressed in Congress about the access of lower income families to basic depository services.

The American Bankers Association cites surveys that concluded that members of credit unions had higher average incomes, higher average educational levels, and a higher rate of home ownership than non-members.[41] Hence, the ABA argues that the credit union industry is giving a faulty image of their membership.[42] Yet an official of the Credit Union National Association cites a recent survey conducted by Gallup for the ABA that found that the average household income of bank customers was $51,000 per year compared to $46,000 per year for credit union members.[43] The Government Accountability Office (GAO) found that "the extent to which credit unions serve persons of modest means is not definitively known because of limited data and lack

(...continued)
November 3, 2005.

[37] American Bankers Association, *The Morphing of Credit Unions*, Washington, 2004, p. 1.

[38] Ibid., p. 2.

[39] Ibid., p. 3.

[40] Ibid., p. 2.

[41] American Bankers Association, *Credit Union Reality Check*, 1996, p. 2.

[42] Ibid.

[43] Fred Stokeld, "Banks Getting Testy Over Competition from Credit Unions," *Tax Notes*, vol. 75, no. 1, April 7, 1997, p. 46.

of indicators."[44] GAO also concluded that "Federal Reserve Board data suggest that credit unions serve a slightly lower proportion of low- and moderate-income households than do banks."[45]

Supporters of the tax exemption argue that credit unions are subject to certain regulatory constraints not required of other depository institutions and that these constraints reduce the competitiveness of credit unions. For example, "credit unions are not subject to the internal control reporting requirements that the Federal Deposit Insurance Corporation Improvement Act of 1991 ... imposed on banks and thrifts."[46] These restrictions arguably impose an implicit tax on credit unions.

Supporters of the tax exemption point out that

> Under changes made to the Internal Revenue Code by the ... Small Business Job Protection Act of 1996, financial institutions, including banks, thrifts, and their parent holding companies, ... [are] able to elect Subchapter S corporation status under the Code and generally receive pass-through tax treatment for federal income tax purposes if certain criteria are met.[47]

Thus, a financial institution with a Subchapter S status is generally not subject to the federal corporate-level income tax. The corporation's taxable income flows through to its shareholders in proportion to their stock ownership, and the shareholders pay federal income taxes on their share of this taxable income.

Supporters of the tax exemption point out that the Credit Union Membership Access Act (P.L. 105-219) states that

> The Congress finds the following:
>
> ... Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.[48]

Debate in the 111th Congress

In the 111th Congress, no legislation specifying the elimination or curtailment of the tax-exempt status of credit unions has been introduced. Some proposed legislation for fundamental tax reform would eliminate numerous tax expenditures including the income tax exemption of credit unions. Fundamental tax reform concerns a major proposed overhaul of the U.S. tax system, which

[44] U.S. Government Accountability Office, *Issues Regarding the Tax-Exempt Status of Credit Unions*, Testimony before the House Committee on Ways and Means, November 3, 2005, p. 19.

[45] Ibid., p.22.

[46] U.S. General Accounting Office, *Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management*, GAO-04-91 (Washington: October 2003), p. 6.

[47] Federal Deposit Insurance Corporation, *Subchapter S Election for Federal Income Taxes*, Financial Institution Letter, October 29, 1996, p. 1.

[48] P.L. 105-219, Sec. 2.

affects the entire tax system or a major component of the system. Most proposals for fundamental tax reform involve the concept of replacing the current income tax system with some form of a consumption tax.[49]

In August 2009, the Congressional Budget Office published a report on budget options which included an option to "Tax Large Credit Unions in the Same Way as Other Thrift Institutions."[50]

> This option would tax the retained earnings of large credit unions—those with more than $10 million in assets—in the same way that the retained earnings of other thrift institutions are taxed. Credit unions with less than $10 million in assets, however, would continue to be tax-exempt.
>
> Allowing small credit unions to keep their tax exemption for retained earnings would affect about 40 percent of credit unions and about 1.5 percent of total assets in the credit union industry.[51]

In the 111th Congress, legislation has been introduced to expand credit unions' ability to make business loans.[52] Banking trade associations argue that the proposed expansion of credit unions' lending authority further reduces the distinction between banks and credit unions, and consequently lessens the justification for the tax exempt status of credit unions.[53] On May 25, in a letter to Representative Barney Frank, Chairman of the Financial Services Committee, Secretary of the Treasury Timothy F. Geithner stated "the Treasury could support proposals to increase credit union member business lending provided safety and soundness concerns are addressed."[54]

Federal Reserve Chairman Ben Bernanke reportedly made extemporaneous remarks that linked higher credit union business lending limits, proposed in S. 2919 and H.R. 3380, with a possible re-examination of credit unions' tax exempt status.[55] On February 24, 2010, Mr. Fred R. Becker, Jr., President/CEO of the National Association of Federal Credit Unions, responded to Chairman Bernanke's remarks with a letter that included the following excerpt:

> On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I write to you today to discuss the unique nature of credit unions and, more specifically, the justification for the credit union tax exemption.
>
> During your recent testimony before the House Financial Services Committee, Rep. Brad Sherman questioned whether Congress should consider lifting the current member business lending cap (MBL) for credit unions. In response, you indicated that MBL limits were one of several restrictions on credit unions that Congress enacted in return for the credit union tax

[49] For an examination of proposals for fundamental tax reform, see CRS Report R40414, *Tax Reform: An Overview of Proposals in the 111th Congress*, by James M. Bickley.

[50] U.S. Congressional Budget Office, *Budget Options, Volume 2*, August 2009, p. 220.

[51] Ibid.

[52] For an analysis of this legislation, see CRS Report R40793, *Credit Union Member Business Loans*, by Pauline Smale.

[53] Bankers Fault Credit Union Tax Exemption As Bill Seeks to Increase Business Lending, *Daily Tax Report*, January 20, 2010, p. G7.

[54] Timothy F. Geithner, Letter to the Honorable Barney Frank, Department of the Treasury, May 25, 2010, p. 1.

[55] Thecia Fabian, NCUA Ready to Oversee Business Lending; NAFCU Asks Bernanke to Review Tax History, *Daily Report for Executives*, February 26, 2010, p. EE8.

> exemption. I strenuously disagree with this characterization as there is nothing to indicate that the member business lending cap, or any other current restriction on credit union activities, was a trade-off in return for the credit union tax exemption.[56]

On August 27, 2010, the President's Economic Recovery Advisory Board (PERAB) released *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation.* The preface of this report states that "it is important to emphasize at the outset that the PERAB is an outside advisory panel and is not part of the Obama Administration."[57]

For corporate tax reform, PERAB presented the option of broadening the corporate tax base and reducing marginal corporate income tax rates. One option to broaden the corporate tax base would be to eliminate or reduce tax expenditures including the exemption of credit union income from tax. PWEAB states that

> Unlike other financial institutions like banks and thrift, credit unions do not pay corporate taxes on their income. This puts them at a competitive advantage relative to other financial institutions for tax reasons. Eliminating this exemption would raise revenue and level the playing field, but would clearly raise taxes on credit unions.[58]

Trends in the Finance Industry

In the future, technological change and regulatory changes may further increase competition between credit unions and other depository institutions. It should be noted that thrift institutions were exempt from the federal income tax until 1951. The tax exemption for thrift institutions was eliminated because Congress felt that the relationship between thrifts and their members had substantially changed. In the 1980s, 1990s, and through 2009, the credit union industry's growth in assets and members was more rapid than other depository industries, and this more rapid growth may continue. Since many believe that an economically neutral tax system requires that financial institutions engaged in similar activities should have the same tax treatment, the income tax exemption for credit unions may occasion continuing debate.

[56] Fred R. Becker, Jr., President/CEO of the National Association of Federal Credit Unions, Letter to Ben S. Bernanke, Chairman of the Federal Reserve System, February 24, 2010, p. 1.

[57] The President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation*, August 2010, p. V.

[58] Ibid., p. 79.

Appendix. Debate in 108th-110th Congresses

The tax exempt status has also been debated in recent congresses. Descriptions of these debates may provide additional insights into the current debate.

Debate in the 108th Congress

In the 108th Congress, top officials of trade associations representing credit unions and commercials banks advocated the interests of their members on the issue of the tax exempt status of credit unions.[59] On February 23, 2004, former Treasury Secretary John W. Snow stated that the Bush Administration opposed taxing credit unions.[60] On March 16, 2004, Donald E. Powell, Chairman of the Federal Deposit Insurance Corporation stated that

> ... credit unions ought to pay taxes. The playing field has shifted in recent years. We've gone from 20 credit unions with assets of more than $1 billion ten years ago to 83 such institutions today. More and more we're seeing credit union advertising touting the benefits of membership over doing business with a bank. In my view, if they are going to compete with banks then we should do our best to ensure that the competition is fair.[61]

On June 2, 2004, three major banking trade groups announced that they had jointed forces to campaign against the tax-exempt status of credit unions. The American Bankers Association, the Independent Community Bankers Association (ICBA), and the America's Community Bankers established the Inter-Trade Credit Union Coordinating Council to campaign against what they considered to be unfair competitive advantages of credit unions, including their tax exempt status.[62]

Debate in the 109th Congress

In the 109th Congress, the tax exempt status of credit unions continued to be debated. On February 23, 2005, Dale Leighty, Chairman of the Independent Community Bankers Association (ICBA), stated in a press release that

> Given the enormous size of the tax subsidy credit unions are receiving, there should be clear and solid evidence that credit unions are fulfilling some unique or extraordinary need in today's highly competitive financial services sector—yet that is not the case.[63]

[59] Marcia Kass, "CUNA Outrage at ABA Priority to Remove Credit Union Tax Exemption Gets Shrug," *Daily Tax Report*, no. 79, April 26, 2004, p. G9.

[60] Marcia Kass, "Snow Praises Credit Unions' Economic Role, Says Administration Opposes Taxing Them," *Daily Tax Report*, no. 35, February 24, 2004, p. G4.

[61] Donald E. Powell, "Remarks before the Independent Community Bankers Association," *FDIC Press Release*, March 16, 2004, p. 1.

[62] "Three Banking Trade Groups Unite to Challenge Credit Unions' Tax Break," *Daily Tax Report*, no. 107, June 4, 2004, p. G5.

[63] Robert T. Zung, "ICBA Cites Study in Push to Eliminate Tax Exemption Granted Credit Unions," *Daily Tax Report*, no. 38, February 28, 2005, p. G8.

Mr. Leighty was referring to a Tax Foundation report sponsored by the ICBA, which was critical of the tax exempt status of credit unions.[64] In response, the Credit Union National Association (CUNA) published an analysis of the Tax Foundation report. CUNA defended the tax exempt status of credit unions and argued that the Tax Foundation study was flawed.[65]

On March 1, 2005, before the Credit Union National Association, then House Ways and Means Committee ranking Democrat Charles Rangel asserted his support for the federal tax exemption for credit unions.[66] On July 15, 2005, at the National Association of Federal Credit Unions' conference, a board member counseled representatives of credit unions on how to retain the tax exemption for credit unions.[67]

On November 1, 2005, the President's Advisory Panel on Federal Tax Reform issued its report, which included two proposals for fundamental tax reform. One proposal would broaden the income tax base and lower tax rates. The other proposal would eliminate most tax preferences and shift the current income tax base to primarily a consumption tax base. Neither of these proposals explicitly recommended the repeal of the tax exempt status of credit unions. Because these proposals would broaden the tax base, however, it was likely that each proposal could have repealed the tax exemption.

Also on November 1, 2005, Ed Yingling, president and chief executive officer of the American Bankers Association (ABA), said that the ABA will use the courts to challenge the credit union tax exemption because the tax exemption gives credit unions an unfair competitive advantage over banks, particularly community banks.[68] On November 3, 2005, the Committee on Ways and Means held hearings concerning the tax exempt status of credit unions. On February 27, 2006, at a CUNA Conference, former Treasury Secretary John Snow reaffirmed the Bush Administration's support for the income tax exemption for credit unions.[69]

On March 22, 2006, former Chairman of the House Ways and Means Committee William Thomas sent a letter to Ms. JoAnn Johnson, Chairperson of CUNA, expressing concern about the independence and objectivity of the NCUA in collecting and analyzing data about the income characteristics of credit union members and the compensation of credit union executives.[70] In his letter, former Chairman Thomas stated

> ... we do not need a cheerleader collecting and analyzing information about whether credit unions are fulfilling the goals intended with their tax exemption. I ask that you be mindful of

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[64] John A. Tatom, *Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions*, Tax Foundation, (Washington: Tax Foundation, 2005), 28 p.

[65] Credit Union National Association, *CUNA Analysis of ICBA/Tax Foundation Study of the Federal Credit Union Tax Exemption*, (Washington, CUNA, March 24, 2005), p. 1.

[66] Alison Bennett, "Lawmakers, Officials Express Support for Credit Union Federal Tax Exemption," *Daily Tax Report*, no. 40, March 2, 2005, p. G8.

[67] "NAFCU Counsels on Retaining Tax Exemption for Credit Unions," *Daily Tax Report*, no. 137, July 19, 2005, p. G7.

[68] Marcia Kass, "ABA Plans to Use Courts to Challenge Credit Union Tax Exemption, Yingling Says," *Daily Tax Report*, no. 211, November 2, 2005, p. G6.

[69] Marcia Kass, "Treasury Secretary Snow Reaffirms Support for Credit Union Tax Exemption," *Daily Tax Report*, No. 39, February 28, 2006, pp. G4-G5.

[70] Kurt Ritterpusch, "Rep. Thomas Critical of NCUA Official's Call for Selling Congress on Continued Exemption," *Daily Tax Report*, no. 57, March 24, 2006, p. G1.

> your proper role as an independent and objective regulator of credit unions as you move forward with your data collection project.
>
> I also want to notify you that I am asking the Government Accountability Office to expand its current review of credit union tax exemption to include an analysis of the independence and objectivity of the NCUA. The NCUA's vigilance is critical to ensuring thorough oversight of credit unions, as well as a balanced analysis of their tax-exempt status.[71]

In November 2006, the National Credit Union Administration released a report titled *Member Service Assessment Pilot Program*.[72] The NCUA stated the this report provided "the most conclusive data to date available on the membership profiles of FCUs [federal credit unions]."[73] The NCUA concluded that their study:

- Demonstrates that FCUs are serving those they have been chartered to serve—working individuals.
- Confirms the expectation that FCUs designated as low-income, with underserved areas, or with a community base have better opportunities to serve lower income groups and individuals and generally have more diverse membership profiles as compared to FCUs with more restrictive common bonds and fields of membership.
- Strengthens NCUA's previous position that changes in membership profiles do not occur immediately—they take time.[74]

But former House Ways and Means Committee Chairman William Thomas stated that the NCUA "still has much more work ahead of them with respect to transparency and data collection."[75] He also asserted that the NCUA had "overstated the strength of the results of the report."[76]

In November 2006, the Government Accountability Office published a report titled *Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangements*.[77] The GAO found that

> NCUA has established the low-income credit union program and allowed adoption of "underserved areas" to increase credit union services to individuals of modest means. Despite increased credit union participation in these programs and the expansion of community charters, the 2004 and 2001 Survey of Consumer Finances indicated that credit unions lagged behind banks in serving low- and moderate-income households. NCUA officials told GAO that, given the nascent nature of its two initiatives and the relatively recent shift to community charters, they did not yet expect observable changes in the data. Also, NCUA recently has undertaken a pilot effort to collect data on the income

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[71] Letter from Representative William Thomas, Chairman of the House Ways and Means Committee, to Ms. JoAnn Johnson, Chairperson of the National Credit Union Administration, March 22, 2006.

[72] National Credit Union Administration, *Member Service Assessment Pilot Program*, November 3, 2006, 80 p.

[73] Ibid., p. 1.

[74] Ibid.

[75] Alison Bennett and Marcia Kass, Thomas Responds to Credit Union Report, Says More Data Needed on Membership," *Daily Tax Report*, November 24, 2006, p. G2.

[76] Ibid.

[77] U.S. Government Accountability Office, *Greater Transparency Needed on Who Credit Unions Serve and on Senior Executive Compensation Arrangement*, report no. GAO-07-29, November 2006, 103 p.

> characteristics of credit union members. Because limited data exist on the extent to which credit unions serve those of modest means, any assessment would be enhanced if NCUA were to move beyond its pilot and systematically collect income data.[78]

GAO also stated that "executive compensation for federal credit unions is not transparent, largely because federal credit unions are not required to publicly file information on executive compensation."[79]

Debate in the 110th Congress

The President's budget for FY2008 did not propose any change in the tax exempt status of credit unions. In the first session of the 110th Congress, the U.S. Treasury introduced two major studies concerning corporate tax reform: "Business Taxation and Global Competitiveness," and "Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century."

Report on "Business Taxation and Global Competitiveness"

On July 23, 2007, the U.S. Department of the Treasury held a conference on "Business Taxation and Global Competitiveness." The Treasury released a background paper that argued that

> The current business tax base includes an array of special provisions that reduce taxes for particular types of activities, industries, and businesses. These provisions take the form of exclusion from income, deductions allowed or enhanced from what otherwise would be allowed, preferential tax rates, income deferral, and tax credits. Some of these provisions are intended to ease tax compliance and administration, such as allowing cash accounting for small corporations, but others were intended by Congress to encourage particular types of activity. The premise underlying many of the special provisions is that they promote activities that have spillover effects, or address various externalities or market failures. Unwarranted tax subsidies may lead to the misallocation of capital, as they encourage investment decisions based on tax characteristics rather than economic fundamentals, and generally reduce economic growth.
>
> Together, these provisions substantially narrow the corporate tax base, which requires that tax rates be higher in order to raise the same tax revenue. For example, it is estimated that these special corporate tax provisions narrow the corporate tax base by roughly 25 percent. If the tax base were broadened by removing these special provisions, the top corporate tax rate of 35 percent could be reduced to 27 percent, or, as an alternative, about 40 percent of investment costs could be written off immediately (i.e., expensed) by all businesses.[80]

The Treasury stated that the United States has the second highest statutory corporate tax rate among countries in the Organization for Economic Cooperation and Development (OECD, an organization consisting of most developed countries).[81] The Treasury maintained that broadening

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[78] Ibid., highlights page.

[79] Ibid., p. 6.

[80] U.S. Department of the Treasury, *Treasury Conference on Business Taxation and Global Competitiveness*, Background Paper, Washington, July 23, 2007, p. 7.

[81] Ibid., p. 35.

the corporate tax base and reducing the statutory corporate tax rate would improve the global competitive position of the United States.[82]

The tax expenditures that the Treasury proposed to eliminate included the "exemption of credit union income," which was estimated to raise $19 billion during the period FY2008-FY2017.[83] This $19 billion would equal approximately 1.53% of the total amount of $1,241 billion from the Treasury's proposed broadening of the corporate tax base.[84] According to a news report, President Bush was considering a fresh plan to cut tax rates for U.S. corporations to make them more competitive around the world.[85]

On July 25, 2007, Daniel A. Mica, President and CEO of the Credit Union National Association, sent a letter to Secretary of Treasury Henry M. Paulson that expressed concern about the Treasury report's listing of the tax-exempt status of credit unions as one of the business tax breaks that could be repealed in order to finance a reduction in the corporate tax rate.[86] Mr. Mica stated that "Such a listing contradicts the 2004 letter to CUNA from President Bush in which he stated, I support strongly the tax-exempt status of credit unions, and will continue to highlight the important contributions that credit unions make to our financial system."[87] Mr. Mica asserted that the Treasury report failed to indicate that banks receive substantial tax preferences including the corporate tax exemption for Subchapter S banks.[88]

On August 10, 2007, the National Association of Federal Credit Unions (NAFCU) indicated that in past statements the Bush Administration had supported the credit union tax exemption and urged the administration to continue supporting the exemption.[89]

On July 27, 2007, Edward Yingling, an official at the American Bankers Association, sent a letter to Henry M. Paulson, Jr., Secretary of the Treasury, that stated

> On behalf of the American Bankers Association, I applaud the Treasury Department's efforts to lower corporate tax rates to help maintain U.S. global competitiveness. This is critical to maintaining the long-term strength of our economy and the financial services industry. Identifying wasteful uses of tax preferences is an excellent way to make the tax system more equitable. One such wasteful tax preference—which is noted in your report in Table 2.1—is the tax exemption for credit unions[90]

[82] Ibid., p. 1.

[83] Ibid. p. 11.

[84] Ibid.

[85] Peter Backer, "Bush May Try to Cut Corporate Tax Rates," *Washington Post*, August 9, 2007, p. A1.

[86] Daniel A. Mica, *Letter to Secretary of Treasury Henry M. Paulson*, July 25, 2007.

[87] Ibid.

[88] Ibid.

[89] NAFCU Urges Bush to Reaffirm CU Support, NAFCU new release, August 10, 2007.

[90] "Bankers Group Applauds Treasury's Efforts to Reduce Corporate Tax Rates, Opposes Exempt Status for Large Credit Unions," letter from Edward L. Yingling, official of American Bankers Association, to Secretary of the Treasury Henry M. Paulson Jr., July 27, 2007.

Report on Competitiveness of the U.S. Business Tax System

On December 20, 2007, the U.S. Treasury issued a report titled *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century.*[91] This report was a follow-up to the July 26th conference report and included the following statement:

> Three broad approaches for reforming the U.S. business tax system are outlined: (1) replacing business income taxes with a business activities tax (BAT), a type of consumption tax, (2) eliminating special business tax provisions coupled with either business tax rate reduction or faster write-off of business investment, potentially combined with the exemption of active foreign earnings, and (3) implementing specific changes that focus on important structural problems within our business tax system. Rather than present a particular recommendation, this report examines the strengths and weaknesses of the various approaches. The various policy ideas discussed in this report represent just some of the approaches that could be considered. This report does not advocate any specific recommendation nor does it call for or advance any legislative package or regulatory changes.[92]

In the first approach, the proposed business activities tax (BAT) is a subtraction-method value-added tax (VAT).[93]

The second approach concerning broadening the business tax base includes a table titled "Special Tax Provisions Substantially Narrow the Business Tax Base," which lists the exemption of credit union income.[94] As previously stated in the July 23, 2007, report, for the period FY2008-FY2017, this table indicates that the amount of revenue that would be raised by eliminating this "special tax provision" would be $19 billion.[95] The total estimated revenue yield from eliminating the business tax preferences (both corporate and noncorporate) would be $1,326 billion, which would allow a reduction in the top business tax rate (both corporate and non-corporate) from 35% to 28%.[96]

On December 21, 2007, in response to the second Treasury report, Daniel A. Mica, President and CEO of the Credit Union National Association, sent a letter to Secretary of the Treasury Henry Paulson. In his letter, Mr. Mica stated

> To achieve the goal of reduced corporate income taxes, the paper focuses on repealing various business tax breaks, listing the exemption of credit union income among the preferences. As we pointed out in our previous letter, such a listing wholly contradicts the 2004 letter to CUNA from President Bush in which he stated, "I support strongly the tax-exempt status of credit unions, and will continue to highlight the important contributions that credit unions make to financial system."

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[91] U.S. Department of the Treasury, Office of Tax Policy, *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century*, December 20, 2007, 116 p.

[92] Ibid., p. ii of executive summary.

[93] For an explanation of a subtraction-method VAT, see CRS Report RL33619, *Value-Added Tax: A New U.S. Revenue Source?*, by James M. Bickley.

[94] U.S. Department of the Treasury, *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century*, p. 48.

[95] Ibid.

[96] Ibid.

> We have already pointed out the inappropriate contrast between the report's silence on the substantial benefits of credit unions to consumers, while lauding Subchapter S Corporations and other flow-through entities that are part of what the report calls the "non-corporate sector" because credit unions are non-stock, not-for-profit cooperatives that operate for the mutual benefit of their members. They do not compete in the marketplace for investment funds with stock companies or other for-profit entities that offer a higher potential return than interest on a savings account.[97]

In response to the issuance of the second Treasury report, reportedly Keith Liggett, senior economist at the American Bankers Association, "applauded the idea of taxing credit union—especially large ones that have moved away from their mission of serving customers of modest means and are morphing into large sophisticated bank-like entities."[98] Mr. Liggett also reportedly said "if the subsidy is not going for its purpose, it questions the efficacy of maintaining this exemption, and if you are going to look at lowering corporate taxes, preferences just really distort the allocation of resources."[99]

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[97] Daniel A. Mica, *Letter to Secretary of Treasury Henry Paulson*, December 21, 2007.

[98] Robert Barba, "Treasury Report Retains Notion of Taxing CUs," *American Banker*, vol. 173, no. 6, January 9, 2008.

[99] Ibid.

Congressional Research Service

Credit Union Member Business Loans

Pauline Smale
Analyst in Financial Economics

February 17, 2010

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CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The credit union industry has long advocated for relief from statutory restrictions on business lending activities. Credit unions can make loans only to their members, to other credit unions, and to credit union organizations. Specific restrictions on business lending include an aggregate limit on an individual credit union's net member business loan balances and on the amount that can be loaned to one member.

Industry spokesmen have argued that the current economic climate reinforces the argument for regulatory relief from limitations on member business loans. The current financial crisis has resulted in a contraction of credit available to small businesses in most sectors of the U.S. economy. Easing the restrictions on member business lending could increase the available pool of credit for small businesses.

The past two Congresses considered but did not pass legislation providing additional lending authority. The banking industry has generally opposed legislation that would increase the powers of credit unions. Current legislation, the Promoting Lending to America's Small Businesses Act of 2009 (H.R. 3380) and the Small Business Lending Enhancement Act of 2009 (S. 2919) would provide credit unions with expanded business loan authority.

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Background

Overview of the Credit Union System

The original concept of a credit union was of a cooperative organization formed for the purpose of promoting thrift among its members and providing them with a source of low-cost credit. During the past couple of decades, technology, competition, and economic conditions have brought many changes to the financial services marketplace that have affected all types of depository financial institutions. The credit union industry has evolved with marketplace changes so that many of the financial services credit unions provide are similar to those offered by banks and savings associations. Credit unions nevertheless remain distinguishable because of their cooperative framework and unique charter requirements. Credit unions are nonprofit, member-owned financial institutions and are subject to specific restrictions not placed on other depository financial institutions. Given that credit unions are considered financial cooperatives, the institutions are exempt from federal income tax. Individual members are taxed on their dividends.

Credit union charters are granted by federal or state governments on the basis of a "common bond." This requirement determines the field of membership, and it is unique among depository financial institutions. There are three types of charters: (1) a single common bond (occupation or association based); (2) multiple common bond (more than one group each having a common bond of occupation or association); and (3) a community-based (geographically defined) common bond.

Individual credit unions are owned by their membership. The members of a credit union elect a board of directors from their institution's membership (one member, one vote). Members' savings are referred to as "shares" and earn dividends instead of interest. Credit union loan and investment powers are more restricted than those of commercial banks. Credit unions can only make loans to their members, to other credit unions, and to credit union organizations. The investment authority of federal credit unions is limited by statute to loans, government securities, deposits in other financial institutions, and certain other limited investments.

The National Credit Union Administration (NCUA), an independent federal agency, is the federal regulator for credit unions. The National Credit Union Share Insurance Fund (NCUSIF) is the federal deposit insurance fund for credit unions. The NCUA manages the NCUSIF for the credit union industry. As of December 31, 2008, there were 7,806 federally insured credit unions. These federally insured institutions held assets totaling $811.2 billion.

Member Business Loans

As mentioned above, a credit union's lending authority is limited to loans to its members, to other credit unions, and to credit union organizations. The definition for member business loans was codified in 1998 by P.L. 105-219[1] (the Credit Union Membership Access Act). A member business loan is any loan, line of credit, or letter of credit used for an agricultural purpose or for a commercial, corporate, or other business investment property or venture. The definition of a member business loan excludes loan(s) of up to $50,000 to one member-borrower. Additionally,

[1] 112 Stat. 920.

the aggregate amount of outstanding business loans to one member or group of associated members is limited to a maximum of 15% of the credit union's net worth or $100,000, whichever is greater. P.L. 105-219 placed additional restrictions on this type of lending. The aggregate amount of member business loans made by a credit union is restricted to the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. Three exceptions to the loan limit are authorized: (1) credit unions that have low-income designation or participate in the Community Development Institutions program; (2) credit unions chartered for the purpose of making business loans (as determined by the NCUA); and (3) those with a history of primarily making such loans (as determined by the NCUA).

The volume of credit union member business lending has increased over time, but member business loans continue to account for a small portion of total lending. From December 2004 to December 2008, total member business loans grew from $12.3 billion to $30.1 billion. In December 2004, member business loans accounted for 3% of all credit union lending, and in December 2008, member business loans accounted for 5.3% of total loans.[2]

Legislation and Policy Issues

Current Legislation

The credit union industry has for several years sought relief from the restrictions placed on member business loans by the Credit Union Membership Access Act. In the 110th Congress, provisions to ease credit union lending restrictions were introduced but not passed. Provisions to increase credit union lending authority were included as part of omnibus regulatory modernization legislation for credit unions, the Credit Union Regulatory Improvements Act (CURIA).[3] Current legislation focuses solely on member business lending. On July 29, 2009, the Promoting Lending to America's Small Businesses Act of 2009 (H.R. 3380) was introduced, by Representatives Paul E. Kanjorski and Edward R. Royce, and referred to the House Committee on Financial Services. On December 21, 2009, the Small Business Lending Enhancement Act of 2009 (S. 2919) was introduced, by Senators Mark Udall, Charles E. Schumer, Joeseph I. Lieberman, Olympia Snowe, Barbara Boxer, Susan M. Collins, and Kirsten E. Gillibrand, and referred to the Senate Committee on Banking, Housing, and Urban Affairs. The intent of both bills is to increase the availability of credit for small businesses and thereby create jobs by providing credit unions with expanded loan authorities. An overview of the provisions of H.R. 3380 and S. 2919 follows below.

Provisions contained in both bills:

- The bills would raise the limit on the aggregate amount of member business loans made by a credit union. It would replace the language restricting the lending to the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets with a flat level of 25% of total assets.

[2] See http://webapps.ncua.gov/ncuafpr/.

[3] For information on legislation in the 110th Congress, please see CRS Report RS22661, *Credit Union Regulatory Improvements Act (CURIA): H.R. 1537 and S. 2957*, by Pauline Smale.

- The definition of a member business loan currently excludes loan(s) of up to $50,000 to one member-borrower. H.R. 3380 and S. 2919 would change this to exclude loan(s) up to $250,000.

The next set of provisions are only covered by H.R. 3380:

- Currently, an insured credit union that is undercapitalized[4] may not make any increase in the total amount of member business lending outstanding at that credit union until the credit union becomes adequately capitalized. The legislation would give the NCUA the authority to waive this restriction and permit the undercapitalized credit union to continue to make new member business loans. The NCUA would have the authority to oversee the member business lending of an undercapitalized institution.
- The member business loan limit would no longer apply to loans to, or loan participations by, nonprofit religious organizations.
- H.R. 3380 would also exclude member business loans made in underserved urban and rural communities. These underserved areas include "investment areas" under the Treasury Department's Community Development Financial Institution (CDFI) program and qualified "low-income areas" under the New Markets Tax Credit Targeting formula adopted by Congress in 2000.[5] Census tracts that would otherwise qualify but in which more than 50% of resident families make more than $75,000 per year would not qualify. In addition, provisions would make a distinction between loans made to businesses operating on a nationwide basis (these would not qualify for exclusion) and loans made to locally owned franchises (operating in an underserved area) of businesses operating on a nationwide basis (these would qualify for exclusion).

The following provision is only found in S. 2919:

- The legislation would require the NCUA to submit semiannual reports to Congress on the status of member business lending. The report would include information on the types and amounts of member business loans, trends in lending, and any recommendations for legislation.

Policy Issues

Credit union advocates have argued that easing the limitations on member business lending would allow credit unions to better serve their membership while enhancing small business formation and growth. In addition, they suggest that current economic circumstances and the general contraction of available credit strengthen the argument for such measures. Banking industry advocates have generally opposed any legislation that would provide credit unions with expanded powers.

Credit union advocates argue that changing the current statutory restrictions on member business lending would increase the opportunity for credit unions to serve their business-owning members.

[4] Defined by Section 216(g)(2) of the Federal Credit Union Act (12 U.S.C. 1790d(g)(2)).

[5] The New Market Tax Credit program was created by the Community Renewal Tax Relief Act of 2000 which was passed as part of Title I of the Consolidated Appropriations Act of 2001 (P.L. 106-554, 114 Stat. 2944).

Advocates claim that the current limits deter individual credit unions (especially smaller institutions) from entering into member business lending because the volume of loans needed to offset the costs of starting and operating a member business loan program often cannot be achieved under the current limits and restrictions. Because the business lending authority would still be limited to members, advocates of easing restrictions claim that this would not undermine the founding principles of credit unions.[6]

Banking industry advocates have raised concerns that greater lending authority for credit unions would unfairly enhance the competitive strength of the latter if credit unions retain their federal income tax exemption.[7] The distinctions between credit unions and banks (especially community banks) have arguably become increasingly blurred. Competition issues may thus arise if credit unions are granted additional bank like powers without being subjected to the same laws and regulations as banks.[8]

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[6] For more information on arguments in support of easing member business lending restrictions, please see a letter to Members of Congress from the Credit Union National Association, which can be found at http://www.cuna.org/download/congress_letter_120809.pdf.

[7] For a discussion of this issue, please see CRS Report 97-548, *Should Credit Unions Be Taxed?*, by James M. Bickley.

[8] For more information on the concerns of the banking industry, please see a letter to Members of Congress from the Independent Community Bankers of America, which can be found at http://www.icba.org/files/ICBASites/PDFs/ltr011410.pdf.

CUNA
Credit Union National Association
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September 20, 2011

The Honorable Scott Garrett	The Honorable Maxine Waters
Chairman	Ranking Member
Subcommittee on Capital Markets and	Subcommittee on Capital Markets and
Government Sponsored Enterprises	Government Sponsored Enterprises
Committee on Financial Services	Committee on Financial Services
United States House of Representatives	United States House of Representatives
Washington, DC 20515	Washington, DC 20515

Dear Chairman Garrett and Ranking Member Waters:

On behalf of the Credit Union National Association (CUNA)[1], thank you for holding the hearing entitled, "Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation". Access to capital for small businesses is absolutely critical given our current economic situation.

One of the crippling blows to economic recovery over the last few years has been the significant decline in business lending by large and community banks. The banks blame their reduced business lending performance on a number of factors: regulator and examiner pressures, reduced demand, and lack of capital. However, what is interesting about the banker excuses for not serving small businesses during the financial crisis is that while banks have turned their backs on many small business customers, credit unions have experienced growth in their business lending portfolios. A lack of demand has not been an issue for credit unions, many of which have former bank customers seeking business loans after having lines of credit withdrawn by the banks. Indeed, in the four years ending June 2007 bank lending to small businesses has declined by 11% whereas credit union business lending has increased rather dramatically. Unfortunately, as the credit unions with the most experience serving their small business-owning members approach the statutory member business lending cap, they will need to pull back their lending to small businesses. In fact, we are already seeing this in some cases.

Representatives Ed Royce and Carolyn McCarthy have introduced H.R. 1418, the Small Business Lending Enhancement Act. This bi-partisan legislation would increase the statutory credit union member business lending (MBL) cap from 12.25% of a credit union's total assets to 27.5%, and impose statutory and regulatory safeguards on the increased lending designed to protect the National Credit Union Share Insurance Fund (NCUSIF) from increased risk. These additional safeguards were designed by the Treasury Department and the National Credit Union Administration (NCUA). If this legislation is enacted, we estimate that credit unions could lend an additional $13 billion to their small business-owning members in the

[1] CUNA is the largest credit union advocacy organization in the United States representing nearly 90% of America's 7,600 state and federally chartered credit unions and their 93 million members.

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first year, helping them to create 140,000 new jobs, without an outlay of a single taxpayer dollar.[2]

The only group that opposes this legislation is the bank lobby. They talk about un-level playing fields and that the legislation may only benefit a handful of credit unions. The problem is that their arguments do not hold water.

If all credit union member business loans outstanding were considered "small business loans," credit unions would still have only 6% of all small business loans at depository institutions and a substantially smaller presence when non-depository providers are factored into the equation.[3] Credit unions represent a small presence in the business loan marketplace and clearly are not a competitive threat to commercial banking interests. Even if the cap were increased as H.R. 1418 proposes and credit unions used all of the capacity under the new cap, the banking industry would still have close to 90% of the small business lending market in the country. Is it not enough for the banks which, in recent years, have demonstrated reduced interest and capacity to meet the needs of small business owners to control 90% of the market? If there is truly an un-level playing field favoring credit unions, how is it that the bankers enjoy such market domination?

The bankers regularly suggest that the segment of the credit union movement approaching the cap is insignificant relative to the size of the movement. Today, there are approximately 175 credit unions that are essentially at the cap (> 10% of total assets); another 180 credit unions are quickly approaching the cap and will likely be capped within 2-3 years (7.5% - 10% of total assets). Together, these credit unions account for approximately 55% of all business loans subject to the cap. These credit unions have been the major contributors to credit union business lending growth in the past few years; however, over the next few years, their loan growth will dry up without an increase in the cap. The banker argument also ignores the fact that the cap has a chilling effect on credit union entry into the business lending arena: For

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[2] Our estimates are based on the following conservative assumptions: 1) no increase in lending by grandfathered credit unions; 2) in the aggregate, non-MBL lenders increase their loans to 1% of assets under the new authority; 3) all other credit unions lend an amount equal to their current "use rate". Estimates arrived at using these assumptions are further adjusted as follows: a) credit unions with net worth/assets <= 6% are assumed to have no growth; b) credit unions with 6% to 7% net worth remain at the current 12.25% cap; c) credit unions with 10%+ MBL/assets are limited to a 30% increase in the first year. The first-year increase is equal to 40% of the new "use rate". Assumptions for increased employment are based on the Council of Economic Advisors May 2009 *American Recovery and Reinvestment Act* job creation estimates ($92,000 in spending creates one job).

[3] FDIC, NCUA and CUNA Policy Analysis.

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many credit unions even capped portfolios under current law are not large enough to justify the sizeable up-front investment necessary to provide this service.

The bank lobby also complains that business lending is not a part of the credit union mission. Unfortunately, they ignore three important facts:

- First, credit unions were created to meet the credit needs of their members – all of them, even the ones that own small businesses.
- Second, credit unions have been engaging in safe and sound business lending since their inception in the United States more than 100 years ago; in fact, some of the first loans credit unions ever made were for business purposes.
- And third, much like consumers needed access to credit following the Great Depression, today small business-owning credit union members are in need of access to credit, which credit unions stand ready to provide if Congress acts.

Finally, the bank lobby would like Congress to believe that credit unions do not have the experience to do this type of lending safely and soundly. The facts suggest just the opposite: credit unions, which are not-for-profit, have demonstrated the ability to do this type of lending safely and soundly, especially in comparison to for-profit bank lenders.

Since 1998, credit union member business loan net charge-offs have averaged an incredibly low 0.26%. Of course, business lending is subject to the fluctuations of the business cycle, so the Great Recession saw an increase in both delinquencies and net charge-offs in credit union business loan portfolios. However, in the first half of 2011, the credit union member business loan net charge-off rate of 0.81% remained lower than the net charge-off rate on credit union consumer loans (1.36%) and also was lower than the net charge-off rate on total credit union loans (0.95%).[4]

Credit union business lending also reflects substantially greater strength than business lending at other financial institutions. Since 1997, credit union member business loan net charge-offs rates have been roughly one-fourth the bank average (0.23% vs. 0.90%). Additionally, in 2010, credit union MBL net charge-offs averaged less than one-half the bank rate (0.74% vs. 1.75%), and in the first half of 2011 credit union MBL annualized net charge-offs remained lower than the bank rate (0.81% vs. 0.86%) even though the bank rate declined dramatically in the period.[5]

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[4] NCUA and CUNA Policy Analysis.
[5] FDIC, NCUA and CUNA Policy Analysis.

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We understand that your subcommittee does not have jurisdiction over H.R. 1418. However, any serious discussion of access to capital must include credit union business lending and the restrictions Congress placed on such lending in 1998. It is clear that credit unions have a history of safe and sound lending, have consumer demand for our products (as evidenced through our growth), and have a willingness to help small businesses owners weather the current economic situation.

On behalf of America's credit unions and their 93 million members, thank you very much for considering our views.

Best regards,

Bill Cheney
President & CEO

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September 6, 2011

The Honorable Joe Barton
U.S. House of Representatives
Washington, D.C. 20515

Via Fax 202.225.3052

RE: Credit Union Quest for Additional Commercial Lending Authority

Dear Representative Barton:

It is apparent that the credit union industry is working diligently to again attempt to increase their already generous limitations on commercial lending. Legislation has been introduced in the House (H.R. 1418) and Senate (S. 509) to increase the cap on business loans to 27.5 percent of assets (with a process for regulatory approval, which based upon longtime observations is not a significant hurdle) – more than double the current limitation of 12.25 percent. We have historically believed that this is an exceptionally bad idea, and **continue to be inalterably and fervently opposed to these legislative initiatives.**

As the issues have not changed over the years, we have opted to reprint our delegation letter of May 6, 2010 regarding similar legislation introduced in the 111th Congress. While fairly unusual for communications with our Congressional delegation, we believe the salient points made in our prior letter remain valid today, and reinforce our historic opposition to what appears to be a power grab by a handful of large, nontraditional credit unions.

May 6, 2010

RE: Expanded Commercial Lending Authority for Credit Union Industry

The credit union industry is again attempting to enjoy "the best of both worlds" through their aggressive lobbying for increased commercial lending authority. **The Independent Bankers Association of Texas wishes to reiterate and reinforce our most vehement opposition to H.R. 3380 or any other avenues to accomplish this inappropriate legislative initiative.**

Community bankers across Texas and the nation are competing with tax exempt competitors in the form of credit unions, which serve the same customers and offer virtually the same products. There is unanimous and adamant opposition among these community bankers to this unjustified power grab by this rapidly growing sector of the financial services industry.

Credit unions were created to serve individuals of "modest means" within an identifiable "common bond". As this industry has evolved, it is difficult to argue with any credibility that it has remained even remotely close to this business model. Virtually anyone, anywhere can join any number of credit unions. The "common bond" is truly a sham, and there simply is no exclusivity whatsoever. Additionally, recent GAO studies indicate that banks serve a higher percentage of low to moderate income consumers than do credit unions. No wonder they have vociferously fought legislative efforts to subject them to the Community Reinvestment Act.

"Promoting Lending to America's Small Business Act of 2009" (H.R. 3380), and other similar initiatives (including S. 2919) increase already liberal commercial lending authority for credit unions. Additionally, it allows undercapitalized credit unions to participate in this expanded authority, and lifts caps altogether for lending to a very broadly defined "underserved area". Any extension of credit of $250,000 or less is not included in the new 25% of assets threshold (up from 12.5%) – a fivefold increase over existing law.

The credit unions argue that this proposal is beneficial because it will provide additional credit to small business borrowers with no taxpayer dollars expended. This is a specious argument for several reasons. First, as you are likely aware, credit unions are not subject to federal income tax and are exempt as well from a number of state and local taxes. A shift in lending from taxable banks to non-taxed credit unions would take away substantial sums of tax dollars, as the interest collected on these loans would no longer be subject to tax. In this era of deficit spending, one is hard pressed to discern where that lost revenue to the Treasury would be made up.

Second, small business lending is virtually the last remaining market niche for our nation's community banks. The SBA Office of Advocacy recently published data indicating that community banks with assets less than $1 Billion make 31.3% of the small business loans under $1 Million, yet hold only 11.5% of the total banking industry assets. Lending in Texas domiciled banks actually increased 13.4% in 2009. Interestingly, past due loans (90 days or more) increased 348%, nonaccrual loans were up 126% and total charge-offs reflected a 138% increase during the same period. Even in the face of a deteriorating economic environment, community banks continue to lend – though a number of borrowers are obviously showing signs of stress.

These are difficult times with much uncertainty, not only in the financial services industry but among small business owners as well. Small business lending is risky, difficult and each request is unique. The large banks are not heavily into this market segment as small business lending does not "fit into a box". Formulas and computer generated analyses simply do not work. One would have to question the wisdom of a credit union that would make a small business loan after said loan request had been turned down by a number of commercial banks. A creditworthy loan request will find a willing lender among the multiple options available. Community banks want to lend money – it's what we do.

Based upon discussions with several former credit union executives now in commercial banking, as well as executives with savings banks that converted from credit unions, the regulatory scrutiny of banks far exceeds that of the credit union regulators. In addition to a lesser level of regulatory oversight, this added risk and lack of expertise in the small business lending arena is a disturbing recipe for trouble in the future. Please remember that the commercial banking industry is still paying FICO premiums for an expansion of lending authority and powers in the thrift industry in the 1980's. You no doubt understand why we have some concerns under the proposed scenario to do effectively the same thing yet again.

With the advent of captive auto finance entities (Ford Motor Credit, GMAC/Ally Bank, etc.) and the proliferation of credit union financing at the dealerships, auto financing by community banks is virtually non-existent. Most auto dealerships have exclusive arrangements with one or more credit unions, at times in a different state, to provide auto financing. The "common bond" requirement is seemingly never a problem for new customers.

With the built in pricing advantage of operating without contributing a single dime to the United States Treasury in the form of income taxes, credit unions can significantly undercut taxpaying community banks on rate. It is the epitome of an unlevel playing field, and leads a rational thinker to seriously question their continued tax exemption. We obviously have great concerns that this pricing advantage will foster the migration of even more small business lending to the tax-exempt credit union industry to the detriment of community banking.

The credit union lobby points to a number of community banks which have elected Subchapter S tax treatment, and intimates that they do not pay income taxes. Such statements are misleading at best and quite disingenuous. Shareholders of these banks pay a pro-rata portion of the bank's earnings at their marginal federal income tax rate. Sub S bank shareholders do avoid the "double taxation" of a C-Corp entity, but are definitely liable for taxes on the earnings of the institution. We as an industry would be delighted if the credit unions would pay federal income tax based upon a similar formula. We are unaware of any offers from the credit unions to do so.

Several credit unions wishing to make more commercial loans have converted to mutual savings banks. Interestingly, there are provisions in the financial reform packages currently being debated in Congress to establish a mutual commercial bank charter. It should be noted that the regulatory and deposit insurance agency with responsibility for credit unions (NCUA) was criticized repeatedly in Congressional hearings for erecting virtually insurmountable roadblocks in front of credit unions wishing to convert. It is inconceivable and illogical that a credit union would have to "jump through such hoops" and get approval from the NCUA prior to conversion to another charter type.

There are multiple options other than allowing credit unions to be de facto banks and further blurring the very thin lines separating these entities from community banks. As stated, allow an expedited and reasonable conversion option to those credit unions wishing to maintain mutual ownership, yet make more commercial loans. This would entail taxation of earnings, which would no doubt be unpalatable. Another option to be explored would be tax parity for community banks and credit unions. Either tax credit unions, or provide significant tax exemptions for community banks doing the same thing to and for the same customer base.

The community banking industry, and we believe the small business borrowers we serve, stand to lose tremendously if these proposals become law. We did not start this fight, but our members are livid over unfair credit union competition and their insatiable appetite for further favored treatment. We hope that you will thoughtfully consider these comments, and refrain from cosponsorship or support of the credit union's quest to further expand their activities.

Sincerely,

Christopher L. Williston, CAE
President and CEO

Stephen Y. Scurlock
Executive Vice President

The challenges facing the community banking industry are significant. Our small but important segment of the financial services industry can be a primary engine of economic recovery and growth. Legislation to provide further competitive advantages to an already favored credit union industry is, in our opinion, inappropriate and unacceptable.

As always, we appreciate your consideration of our comments, and would be happy to provide additional information or follow up.
Sincerely,

Respectfully submitted,

Christopher L. Williston, CAE
President and CEO

October 12, 2011

Financial Institutions and Consumer Credit Subcommittee hearing entitled, "H.R. 1418: The Small Business Lending Enhancement Act of 2011"

NAFCU witness Gary Grinnell Responding to Question #1 submitted for the hearing record by Representative Hinojosa.

Question #1:

Despite growth in member business lending, none of the credit unions came close to the 12.25 percent of assets threshold beyond which they cannot make additional member business loans. Please provide me the data indicating that Congress should pass, "H.R. 1418: the Small Business Lending Enhancement Act."

Answer from Gary Grinnell:

Thank you for recognizing that throughout the financial crisis (2007 through 2011) credit union lending not only continued, but actually increased. As you noted, total member business loans (MBLs) increased by 44 % during this timeframe. While it is true that all not all credit unions have reached their member business lending cap, I would like to note that at Corning Credit Union we currently exceed 80% of our current cap, and forecast that we will reach the cap by mid-2012 if Congress does not act. Because of our limited growth potential due to the proximity of our cap, we have refrained from advertising or marketing our business services. We have also held off on hiring additional staff members to support our MBL portfolio. I would point out the letters submitted for the record by a number of small businesses we serve, and even the Mayor of Wilmington, NC, that outline how many other institutions are not making the small business loans that are needed.

To address your question about credit unions that are not close to the cap, I feel it is important for Congress to understand that the mere existence of the cap serves as a disincentive for credit unions, especially smaller ones, to invest in the upfront resources necessary to have a successful MBL program. Knowing there is an arbitrary cap, many credit unions feel that success in creating and growing a program that would ultimately be met by an arbitrary cap is not cost efficient in terms of resources invested and potential return. In short, the existence of the cap is a serious barrier to entry and eliminating it would encourage additional credit unions to engage in the member business lending activities that will help create jobs and help our economy get stronger.

Raising the cap will help spur $13 billion in lending and create over 100,000 jobs nationally in the first year alone. This is stimulus that doesn't need a dime of taxpayer money.

NAFCU witness Gary Grinnell Responding to Question #2 submitted for the hearing record by Representative Hinojosa.

Question #2:

Community bankers strongly oppose H.R. 1418 and argue that Congress should not expand credit union business lending powers unless it is also prepared to tax credit unions and require them to comply with the Community Reinvestment Act (CRA). Community bankers' concern is that credit unions have strayed far from their statutory missing; are abusing their tax-exempt status; and are seeking to go even farther. Mr. Grinnell, would you like to respond to these allegations?

Answer from Gary Grinnell:

This argument by the community banks seems to ignore the facts of history – credit unions existed and made business loans for 90 years without an arbitrary cap. The Federal Credit Union Act states that credit unions are established to make credit available for "provident purposes." Making loans to our nation's small businesses seems like a provident purpose.

The banking industry has long argued that the credit union MBL cap should not be raised due to the credit union federal tax exemption. As discussed in my written testimony, the community bankers are quick to forget that a large number of banks do not pay corporate federal income tax because of their Subchapter S status. There are approximately 2,358 Subchapter S banks that avoid federal income taxes today. It's also worth noting that the value of the Subchapter S federal tax break for banks is $2.05 billion for 2010, which is significantly greater than the estimated value of the entire credit union tax expenditure ($1.27 billion) for FY2010 as included in the President's FY2012 budget. Furthermore, they continue to advocate legislation (in the form of H.R. 1697) that would actually expand their own Subchapter S tax breaks.

With respect to expanding the Community Reinvestment Act (CRA) to credit unions, the banking industry knows that CRA was adopted in the face of clear evidence of redlining and divestment. Credit unions have not, and do not, engage in such tactics. As you know, it's practically impossible for credit unions to participate in divestment to begin with given the defined fields of membership that credit unions must operate within.

The kind of outrageous claims the banking industry has made in opposition to altering the credit union member business lending cap serve as evidence that they are only willing to support ideas that are wholly self-serving. For example, as you may recall, the bank backed $30 billion Small Business Lending Fund (SBLF), in many cases wasn't even used for additional business lending. Through Congressional oversight hearings it's been uncovered that many of the banks that are fighting the credit union MBL legislation took money from the SBLF to pay off previous TARP debts as opposed to helping small businesses and getting people back to work.

If H.R. 1418 were to become law, would the additional small business lending it authorizes help create jobs in the broader economy as demand increases?

Under H.R. 1418, credit unions would be allowed to further leverage their tax advantage and compete even more with tax-paying banks. The result of this competition would **not** be an overall increase in business lending. Rather, an increase in the business loan cap would cause some business loans that are currently being made by taxable financial institutions to be shifted to credit unions. Therefore, H.R. 1418 would have minimal impact on job creation.

Moreover, shifting loans in this manner would result in less taxes being paid by banks, leading to an increase in the federal deficit at the very time Congress is looking for ways to reduce it. In fact, the Congressional Budget Office (CBO) in 2010 scored a bill that would raise the credit union business lending cap as an increase to the deficit of $354 million over 10 years relative to the CBO baseline.

The expansion of the credit union charter will cause the credit union tax expenditure, which is currently at $7.92 billion over the next five fiscal years, to grow larger. This will increase the federal debt and ultimately contribute to higher interest rates, which will hurt job creation.

Why do you ask that an expansion of credit unions commercial lending limit by offset by imposing a federal tax on them? Would this create a level playing field?

H.R. 1418 is nothing less than legislation that would allow a credit union to look and act just like a bank, without the obligation to pay taxes or have bank-like regulatory requirements, such as the Community Reinvestment Act, applied to them. This credit union tax expenditure takes revenue from banks that compete for these same loans – revenue that would be taxed and would help to offset some of the current federal budget deficit.

The principle of tax equity states that equals should be treated the same by the tax code. Therefore, institutions that are engaged in the same lines of business and are in competition with one another for the same customers should be subject to the same tax treatment.

For example, Congress in 1951 repealed the tax exemption for cooperative banks and mutual savings associations because it found that these institutions were in active competition with taxable institutions and continuing their tax exemption would be discriminatory.

Additionally, the President's Economic Recovery Advisory Board (PERAB) in 2010 came to the same determination when it set forth as a policy option the repeal of the credit union tax exemption. PERAB wrote:

> Unlike other financial institutions like banks and thrifts, credit unions do not pay corporate taxes on their income. This puts them at a competitive advantage relative to other financial institutions for tax reasons. Eliminating this exemption would raise revenue and level the playing field, but would clearly raise taxes on credit unions.

Taxation will level the playing field.

But there is an alternative – eliminate the current impediments for credit unions to switch their charters to become a mutual savings bank. This charter provides greater flexibility, still preserves the mutual-member focus that credit unions find desirable, and is accompanied by the effective and experienced supervision of traditional banking regulators. Removing the National Credit Union Administration's obstructionism with regard to a conversion to a mutual savings bank charter will benefit those credit unions that have outgrown their charter, and will also improve the fiscal position of the United States as these entities pay their fair share of taxes.

How much revenue would Treasury receive if credit unions were taxed?

According to the Office of Management and Budget, the tax expenditure arising from the tax exemption of credit unions is estimated at $7.92 billion over fiscal years 2012 through 2016. The credit union tax exemption is the 13th largest corporate tax expenditure.

ABA estimates that the tax expenditure could approach $21 billion or more over the next ten fiscal years.

QUESTIONS OF THE HONORABLE RUBEN HINOJOSA
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
HEARING ON
"H.R. 1418: THE SMALL BUSINESS LENDING ENHANCEMENT ACT OF 2011"
OCTOBER 12, 2011

Question #1 for Mr. Gary Grinnell of NAFCU and Mr. Jeff York of CUNA:

At a time when many businesses are having difficulty obtaining access to credit, some contend that "H.R. 1418: The Small Business Lending Enhancement Act of 2011" will provide important credit opportunities for small- and medium-sized businesses. Among other provisions, this legislation would remove the existing limits on small business lending for thrifts, thereby enhancing the role of savings associations as community leaders. The Homeowners Loan Act currently caps the aggregate amount of commercial loans other than small business loans at 10 percent of a savings association's assets, and it permits commercial lending, including small business lending of up to 20 percent of assets.

According to the Small Business Administration's Office of Advocacy, smaller businesses have experienced difficulty in obtaining relatively small loans from large commercial banks that set minimum loan amounts relatively high. Savings associations are increasingly important providers of small business credit and communities throughout the country.

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 loan (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.

Despite this growth in member business loans, none of the credit unions came close to the 12.25 percent of assets threshold beyond which they cannon make additional member business loans. Please provide me the data indicating that Congress should pass "H.R. 1418: The Small Business Lending Enhancement Act of 2001?"

How much revenue would Treasury receive if a federal tax were imposed on all credit unions?

Response of Mr. Jeff York on behalf of the Credit Union National Association:

Before addressing the two questions raised herein, I need to clarify that H.R. 1418 would permit well-capitalized credit unions with significant business lending experience which are operating near the statutory cap on credit union business lending and receive the approval of their regulator to lend up to 27.5% of their assets to small businesses. The legislation does not affect any lending caps related to savings associations.

To your question regarding why Congress should pass H.R. 1418, the data simply do not support the argument that, "Despite this growth in member business loans, none of the credit unions came close to the 12.25 percent of assets threshold beyond which they cannon make additional member business loans."

Credit union business loan growth is now slowing because more and more credit unions are approaching 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. Therefore, most credit unions find it necessary to begin backing off the throttle once business loans get much above 8% of assets, and then begin to put on the brakes after business loans exceed 10% of assets.

As of June, 2011 the following conditions held with respect to credit union proximity to the cap (excluding grandfathered credit unions):

- A total of 227 credit unions now 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. Their business loans grew at an annual average rate of 21% in the three year period ending June 2010 but then slowed to 13% in the following year ending June 2011. Their business lending will continue to slow dramatically in the coming few years without an increase in the cap.

- Another 149 credit unions now 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. Their business loans grew at an annual average rate of 17% in the three year period ending June 2010 but grew only 2% in the year ending June 2011. Their business lending will continue to stagnate 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. Their business loans grew at an annual average rate of 9% in the three year period ending June 2010 but grew only 1% in the year ending June 2011. These credit unions 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. But, as the above data shows, these credit unions have recently curtailed their growth as they have begun to approach 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.

You also asked how much revenue Treasury would receive if a federal tax were imposed on all credit unions.

According to the "Estimate of Federal Tax Expenditures for Fiscal Year 2010-2014," the credit union federal tax status is classified as a tax expenditure which reduced federal revenue by $400 million in fiscal year 2010; $300 million in fiscal year 2011. The Joint Committee on Taxation estimates the cost of this tax expenditure to total $2.3 billion for fiscal years 2010-2014.[1]

By contrast, consumers receive more than a tenfold benefit as a result of not-for-profit credit unions operating with this federal tax status. Credit union members benefit through fewer and lower fees on services, lower interest rates on loans, higher yields on deposit accounts and better service.

This substantial leveraging occurs because the tax expenditure provides a significant incentive for credit unions to maintain their structure as member-owned, not-for-profit financial cooperatives. Compared to for-profit banking institutions, this structural difference means that credit unions pay no dividends to shareholders and credit union profits can thus be passed through directly to the nation's 93 million credit union members. Removing the tax exemption removes the incentive to maintain this structure and puts these significant consumer benefits at risk.

Question #2 for Mr. Gary Grinnell of NAFCU and Mr. Jeff York of CUNA:

Community bankers strongly oppose H.R. 1418 and argue that Congress should not expand credit union business lending powers unless it is also prepared to tax credit unions and require them to comply with the Community Reinvestment Act. According to the Independent Community Bankers of America, "the credit union tax exemption is directly linked to and can only be justified by their original mission of serving individuals of modest means. Any expansion of their powers beyond the original mission should result in the loss of their tax exemption."

Community bankers' concern is that credit unions have strayed far from their statutory mission; are abusing their tax-exempt status; and are seeking to go even farther. According to the ICBA,

[1] Joint Committee on Taxation. "Estimate of Federal Tax Expenditures for Fiscal Year 2010-2014." December 15, 2010. 42.

"credit unions are tax-exempt for a reason and were never meant to be commercial lenders. If they want to break from their tax-exempt purpose then they must pay taxes. That is the only just, logical and fair tax policy."

Mr. Grinnell and Mr. York, would you like to respond to these allegations?

Response from Mr. Jeff York on behalf of the Credit Union National Association:

Credit unions have been making business loans since their inception in the early 1900's. In the first 90 years of their existence, there was no business lending cap at credit unions. The current 12.25% of assets cap was an arbitrary limit imposed by Congress in the Credit Union Membership Access Act in 1998 (CUMAA).

The credit union tax exemption arises from their unique structure as not-for-profit, democratically-controlled cooperatives – and that structure is unchanged over the past 100 years. The tax exemption has absolutely nothing to do with the breadth or volume of credit union product and service offerings – a fact clearly spelled-out by Congress in CUMAA.

It is true that part of the credit union mission is to serve those of modest means. It also is true that many modest means individuals run small businesses and need credit. It is important to note that in the most extensive study of credit union business lending, the U.S. Treasury Department found that 45% of credit union business loans went to households with annual incomes of $50,000 or less and 25% went to households with incomes of $30,000 or less.[2]

In economic downturns, these lower-income business borrowers are especially in need of access to credit because credit is generally more difficult to obtain and unemployed and discouraged job seekers are more likely to form businesses during these events.

Finally, implicit in the banker objection is the notion that every loan a credit union makes is a loan that banks aren't able to make. However, 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.

Bankers often claim 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

[2] Credit Union Member Business Lending. United States Department of Treasury. 2001.

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.[3]

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 basis points, 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 paper 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.[4] Put simply, on average, 80% of the increase in credit union lending is new capital that would otherwise not be available in the marketplace. Thus, the vast majority of new credit union lending is not "siphoned" from banks that would otherwise make these loans.

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[3] 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.
[4] James A. Wilcox. *The Increasing Importance of Credit Unions in Small Business Lending.* SBA Office of Advocacy. Release Date: September 2011.

Below is the National Credit Union Administration's response for the record to Congressman Luetkemeyer's follow-up question for Chairman Matz resulting from the House Financial Institutions Subcommittee hearing on member business lending October 12, 2011:

"What is the percent of credit union business loans that are participated out and the total amount in dollars of credit union loans that are participated out?"

Nearly 22 percent of member business loans (MBLs) are participated out to credit unions. This includes each participation interest sold and each portion retained by the credit union serving as lead lender.

MBL participations amount to just under $8 billion.

Total credit union loan participations – which include other types of loans in addition to MBLs – amount to $12.8 billion.

Trends over the past five quarters appear in the table below:

	6/30/2010	9/30/2010	12/31/2010	3/31/2011	6/30/2011
Percent of MBLs Participated Out	22.19%	22.03%	22.15%	22.03%	21.95%
$ MBL Participations	$ 7,693,075,940	$ 7,752,555,669	$ 7,881,612,270	$ 7,864,177,560	$ 7,958,975,547
$ Total MBLs	$36,272,621,974	$36,736,909,550	$37,179,215,940	$37,411,008,076	$37,963,244,605
$ Total Loan Participations (including MBLs + other loan types)	$12,427,097,393	$12,586,904,649	$12,462,065,881	$12,340,767,328	$12,815,992,014

To put this in perspective, total credit union loans amount to $564 billion. Participations currently represent 2.27% of total credit union loans.

Loans are participated out for several reasons. Some credit unions participate out MBLs when they are near the statutory MBL cap. Others begin selling participation interests when they reach an internally defined capacity level. And depending on the size and type of each loan, some sell participation interests to improve servicing through syndication among several credit unions.

Credit unions buying loan participations also have several different reasons: diversifying their portfolios, strengthening earnings, and using excess liquidity to increase the availability of credit to small businesses and consumers.

NCUA expects credit unions buying participation interests to conduct the same levels of due diligence as if they were originating each loan in-house. NCUA is planning to propose an updated regulation on loan participations next month.

CITY OF WILMINGTON NORTH CAROLINA

Office of the Mayor

Bill Saffo, Mayor

October 6, 2011

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

Dear Chairman Capito:

My name is Bill Saffo, and I am the Mayor of Wilmington, North Carolina. I am writing to ask for your support of H.R. 1418, the Small Business Lending Enhancement Act of 2011, which would lift the arbitrary member business lending cap on credit unions.

Wilmington is eighth largest city in North Carolina, with a population of over 100,000 residents. We are the county seat of New Hanover County, and are situated in one of the fastest growing regions of the state, and of the country.

In my position, I have witnessed directly the impact that a lack of available capital to small business has had during the economic crisis of the past three years. I have had numerous conversations with business owners and developers in my city about the difficulty they have had in obtaining financing from national and local banking institutions during this recession. Banks that had developed strong ties to this area over the course of decades have suddenly stripped local businesses of their access to credit, calling existing loans and lines of credit at exactly the time that our business community needed it the most. These lifelines are critical in helping small businesses not only to survive in this economy, but also to be able to grow, expand, and create new jobs for the future.

While some banks have been laying off workers and closing branches, one financial institution in our area has been moving in the opposite direction. That institution is Corning Credit Union. Over the past couple of years, CCU has opened two new branches in the Wilmington area, and has helped numerous business members obtain the financing they needed to stay afloat, grow and create new jobs. CCU is a safe and sound financial institution with conservative lending practices and delinquency rates among the lowest in the nation. Now I understand that CCU is facing a challenge of its own. CCU's biggest challenge is the arbitrary member business lending cap, which is limiting their ability to grow their presence in Wilmington and provide much-needed financing to our business community.

As the Mayor of Wilmington, I am counting on you to help North Carolina's small businesses by leading the effort to raise the cap on credit union business lending. Thank you for your consideration of this important issue.

Sincerely,

Bill Saffo

Bill Saffo

Cc: Congressman Mike McIntyre

Office of the Mayor
City of Wilmington | City Hall | 102 North Third Street | PO Box 1810 Wilmington, NC 28402-1810
910 341-7815 | 910 341-4628 fax | wilmingtonnc.gov | Dial 711 TTY/Voice

Additional Material submitted by Gary Grinnell for hearing record

October 6, 2011

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

Dear Chairman Capito:

My name is Dave Sweyer and I am the Owner/President of Century 21 Sweyer and Associates based in Wilmington, NC. I am writing to ask for your support of H.R. 1418, the Small Business Lending Enhancement Act of 2011, which would lift the arbitrary member business lending cap on credit unions.

My business is just one of the many in North Carolina that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact North Carolina's economy.

In my experience as a business owner in the Wilmington area during the past two decades, I have had exposure to all the banks in Wilmington. My father, who started our company, did business with SunTrust for 15 years. We've also worked with Crescent State Bank, First Bank, Bank of the Ozarks and many of the other national and local banking institutions over the years. In the last several years, traditional banks operate as if customers are a bad thing. In contrast, at Corning Credit Union (CCU), people know my name every time I walk into my branch and they care about me as a member. I'm impressed by that, and it is something I have not experienced at another financial institution in many years. This is the way banking used to be. Unfortunately, retail banks are no longer able or willing to put the customer first. In the wake of the recent financial crisis, for the banks, fixing their internal problems takes precedence over the needs of their customers.

I do my personal banking as well as business banking at CCU. I recently obtained an auto loan through my credit union to purchase two cars for my business. It was approved in two hours; I worked with my local loan officer, Phil, and was in and out of the branch with a check in hand. If I had gone to a bank for this loan, they would have put me through the ringer. My first commercial loan with CCU was a similarly smooth process and it was handled with a human touch. Unfortunately, CCU is nearing their cap limit. They have been upfront with me about the challenges of being able to meet my needs for my next commercial loan, due to the difficulty in locating suitable participants at the terms and rates I need, within a reasonable amount of time. Despite the strength and success of my business, I am concerned about my ability to obtain commercial loans in the future from my credit union, one of the few financial institutions still lending to businesses in Wilmington.

As a member of Corning Credit Union, I believe that the quick, straight-forward access to loans credit unions provide is essential to business owners; it has a huge impact on

Century 21 Sweyer & Associates

businesses and their employees. We've been able to expand our business with loans we received through Corning Credit Union. That adds a lot of security during this time of recession, when we need to keep our business open and our employees and families working and earning. Simply put, our relationship with Corning Credit Union is very positive because the credit union works hard to establish and maintain that relationship. Business owners really appreciate that effort, and that well-earned rapport makes our financial business dealings easier and more pleasant. For these and many other reasons, I believe this legislation to increase the credit union lending cap should be supported.

My fellow credit union business members and I are counting on you to help North Carolina's small businesses by leading the effort to raise the cap on credit union business lending. Thank you for your consideration of this important issue.

Sincerely,

Dave Sweyer, Owner/President
Century 21 Sweyer and Associates

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October 7, 2011

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

Dear Chairman Capito:

My name is Ken Dull, and I am the President/Owner of McKinley Building Corporation, a commercial construction company based in Wilmington, NC. I am writing to ask for your support of H.R. 1418, the Small Business Lending Enhancement Act of 2011, which would lift the arbitrary member business lending cap on credit unions.

My business is just one of the many in North Carolina that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact North Carolina's economy.

My recent experience with the banks in Wilmington has not been positive. The banking industry as a whole seems to be frozen and unsure of their mission or direction. This is not the case with Corning Credit Union. They have a clear vision of where they are going and how they wish to support our community. The large, national banks are not doing business in our area at all; they are pulling back, getting out of the lending business and retracting from this market completely. Small community banks also are not providing financing to small business right now because they are too busy fixing their balance sheets, too scared of being absorbed by larger institutions or of disappearing completely.

For North Carolina and the United States to work its way out of this mess, it will have to be on the backs of small business, which has always been the engine of growth and progress in this country. In order to do that, we need community-type institutions that are willing to take normal business risks to help make things happen. Corning Credit Union is one of the only financial institutions in Wilmington that is doing this. In my mind, they are the new community financial institution in our area. Aside from CCU, and unless you are a Fortune 500 company, you have nowhere else to go.

My experience with CCU has been very positive. During these challenging times, the safe thing would have been for my commercial lender, Greg McFetridge to explain that CCU could not take my loan and perhaps they'd look at it another time when economic conditions improved. Instead, Greg did his research and due diligence, found another credit union with the capacity and willingness to participate in the loan, and we got it done. Before CCU came through, this project was on ice. Now I have the capital I need to finish the project and put commercial tenants in my building. This has led directly to jobs in my community – my tenants are putting people to work, and I put people to work finishing my building and moving on to other construction projects. In this way the funds that CCU lent out get recycled through the community and create returns several times over.

Last week I received a call from one of my clients. His story was heartbreaking. Here is a successful businessman, a pillar of the community whose family has been a major supporter of numerous Wilmington institutions for decades. His local community bank was recently gobbled up by one of the big banks, and they just informed him that they were not going to renew his commercial loan which is coming due. He has never had a late payment on this loan. They told him he needed to come up with a million dollar payment or they would foreclose. This action is forcing him into Chapter 11 bankruptcy. There is no willingness to work with the customer. The bank would rather see the customer fail in order to get this performing loan, which they consider "risky", off their books.

The banks' stranglehold on business credit needs to be loosened. Credit unions have filled this gap nicely over the past several years, but their ability to lend to small businesses at this critical time is being jeopardized by the arbitrary business lending cap. For this reason I believe this legislation to increase the credit union lending cap should be supported.

My fellow credit union business members and I are counting on you to help North Carolina's small businesses by leading the effort to raise the cap on credit union business lending. Thank you for your consideration.

Sincerely,

McKinley "Ken" Dull

Cc: Congressman Mike McIntyre

March Properties, Inc.

October 6, 2011

Representative Mike McIntyre
2133 Rayburn House Office
Washington, DC 20515

Dear Congressman McIntyre:

My name is Burney Morris, and I am a small housing developer based in Wilmington, NC. I am writing to ask for your support of H.R. 1418, the Small Business Lending Enhancement Act of 2011, which would lift the arbitrary member business lending cap on credit unions.

My business is just one of the many in North Carolina that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact North Carolina's economy.

It has been a ray of sunshine dealing with Corning Credit Union (CCU), particularly today, a great contrast from the banks. There is a tremendous need for financing for small companies such as mine, those with 50 employees or less. I was completely unaware of credit unions before dealing with CCU. After being raked over the coals and tossed out on the street by the banks, I had to call around. The Credit Union doesn't take a black and white approach to my needs. They are willing to work with me to find the solutions I need for my business. My commercial lender Greg is a great ambassador for CCU and a pleasure to deal with. The services that CCU provides are outstanding. The Credit Union works with me to extend terms or find solutions when needed. Everyone is friendly and knows me, from the tellers to the loan officers to management. Contrast that with SunTrust – they had nine people working out of their special asset division in Wilmington, NC with the sole purpose of beating on me and other small local developers. And then I read in the newspaper just last week that the bank fired the entire division, including the head of the office, who happens to be the former mayor of Wilmington. They have apparently moved to shut down their eastern North Carolina commercial operations completely. And they want to restrict the ability of credit unions to lend in this community?

Small institutions such as credit unions are the only places that are doing any lending now.

6005 Wellesley Pl. Wilmington, NC 28409 (910) 262-4449 Fax (910) 796-6529

I was talking with a local dentist recently, who is looking to expand his office and hire more people. The banks he approached wanted nothing to do with his request. Although the economy is still a challenge, people will always need to have cavities filled, so why the resistance? I find it commendable that CCU is opening branches during this time and is still growing and looking to serve this community. When things got tough locally and nationally a few years ago, my primary bank, SunTrust, called in all of my loans and forced me to pay them all off. I had to sell my home to do it, but I paid them off in full. There was no attempt to work with me, to get through this thing together. And now the big banks have burned so many bridges, their customers won't ever go back again. I'm not the only one here who has had this experience; it's been a bloodbath.

Our relationship with the Corning Credit Union remains a very positive one, largely because the credit union really works hard to establish and maintain that relationship. The rapport the credit union cultivates with its small business owners facilitates our financial business dealings. For these and other reasons too numerous to share, I believe this legislation to increase the credit union lending cap should be supported.

My fellow credit union business members and I are counting on you to help North Carolina's small businesses by leading the effort to raise the cap on credit union business lending. Thank you for your consideration.

Sincerely,

Bernard Morris

Burney Morris, Housing Developer
Wilmington,

Imaginative Manufacturing Inc.

4219 Meads Creek Road
Painted Post, New York 14870
Phone (607) 738-7380
Fax (607) 936-6323

September 15, 2011

Dear Representative:

My name is Scott Austin and I am the founder of Imaginative Manufacturing, Inc., operating in Painted Post, NY. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

Before we became members of Corning Federal Credit Union, banks held us hostage. Traditional banks dragged out the loan decision-making process for lending additional money and charged outrageous interest rates. They would not lower the rates, regardless our repayment history. We need financial institutions that will work with us and not just use our company for large financial gains and drain us. It is critical that small businesses have access to financial capital to grow and survive in this strained economy. Corning Federal Credit Union cares about its members, community and partners. We need financial institutions that are not just about profits, but people.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

Scott Austin

Scott Austin, Founder/Proprietor
Imaginative Manufacturing, Inc.

Corning Mini Storage, LLC
8805 Rt. 415, Campbell, NY 14821
607-962-2583 ❖ info@CorningMiniStorage.com

September 15, 2011

Dear Representative:

My name is C. Cameron Dunlap and I am the Owner of Corning Mini Storage, operating five locations in Corning, New York and the surrounding area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

Credit Unions are a huge help to local businesses and communities. Corning Credit Union has been there for me through the purchase of 5 facilities and 2 construction projects during the last three years. The working relationship has been amazing and the service… consistently excellent. If not for credit unions, I don't know if there would be any business lending going on at all. They are filling the void that commercial lenders have created.

Credit Unions operate with great aversion to risk, which I believe is the reason they are healthy today and commercial institutions are not. The fact that Credit Unions thrive today should be rewarded, not penalized by a lending cap. Government really needs to level the playing field.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

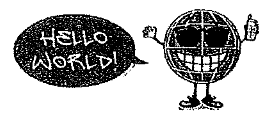
Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

C. Cameron Dunlap, Owner
Corning Mini Storage

Wireless World

17 E. Market St
Corning, NY 14830
607.962.1600



September 15, 2011

Dear Representative:

My name is Rosetta Kellberg and I am the proprietor of Wireless World operating in the Corning area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union, my business uses the Credit Union for payroll processes and tax services and insurance for our building. It's where we have banked for decades. They're just more personable and care more about local businesses because Credit Union representatives are directly involved with the local community. They make it easier and more pleasant to do any kind of financial business that needs to be done. We need more access to this kind of financial institution, without government-imposed limits that hamper its ability to support small businesses and our communities.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

Rosetta Kellberg, Proprietor
Wireless World

BILDAN PRECISION MANUFACURING
P. O. Box 236
Elmira Heights, New York 14903

April 26, 2011

Dear Representative:

My name is Bill Allard and I am one of the owners of BilDan Precision Manufacturing, Inc. operating in Elmira Heights, New York. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a credit union member, I like the fact that Corning Credit Union is local and that when I work with them, our money stays in the community. There's also a nice, small-town bank feel when I work with the credit union. I can talk with representatives anytime I want to, the rates are competitive, and the service is always excellent. Increasing the lending cap will help my business because we'll need to invest about $175,000-$200,000 in capital equipment to expand our business. As we continue to grow, we'll want to keep using Corning Credit Union. We don't want to be frozen out of working with our preferred lending institution because our Credit Union has reached its cap. I don't want to be forced to go through the lengthy process of trying to find a traditional financial institution willing to work with us. I want the ability to expand my business and to continue to keep my financial business where I want it, with the Credit Union. Increasing the lending cap will serve that purpose.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

William B. Allard

Bill Allard, Owner
BilDan Precision Manufacturing, Inc.

KLUGO ENTERPRISES, LLC
11849 East Corning Road
Corning, New York 14830

September 16, 2011

Dear Representative:

My name is Charles Klugo and I am the owner of Klugo Enterprises, LLC operating in the Corning area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union and an accountant, I meet with many clients who need business financing. Corning Credit Union works well with people and their representatives have a great attitude. They're very easy to work with. When people need loans, they often need a swift response. Banks have time-consuming application and approval processes that are difficult for people to navigate, but CCU moves quickly and smoothly to help businesses with financing.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

Charles E. Klugo

Charles Klugo, Owner
Klugo Enterprises, LLC

KAYDEN INDUSTRIES INC USA
224 North Main Street
Horseheads, New York 14845

April 21, 2011

Dear Representative:

My name is Bill Cavaluzzi and I am the Chief Financial Officer of Kayden Industries Inc. USA operating in the Corning area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union and an accountant, I meet with many clients who need business financing. Corning Credit Union works well with people and their representatives have a great attitude. They're very easy to work with. When people need loans, they often need a swift response. Banks have time-consuming application and approval processes that are difficult for people to navigate, but CCU moves quickly and smoothly to help businesses with financing.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

Chief Financial Officer
Kayden Industries Inc. USA

CAVACO MANAGEMENT GROUP
124 West Franklin Street
Horseheads, New York 14845

April 21, 2011

Dear Representative:

My name is Bill Cavaluzzi and I am the owner of Cavaco Management Group operating in the Corning area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union and an accountant, I meet with many clients who need business financing. Corning Credit Union works well with people and their representatives have a great attitude. They're very easy to work with. When people need loans, they often need a swift response. Banks have time-consuming application and approval processes that are difficult for people to navigate, but CCU moves quickly and smoothly to help businesses with financing.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

Bill Cavaluzzi, Owner
Cavaco Management Group

ARIN'S AUTO
6004 State Route 13
Cayuta, New York 14824

September 16, 2011

Dear Representative:

My name is Arin Walter and I am the owner of Arin's Auto operating in the Cayuta and Alpine area. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union and an accountant, I meet with many clients who need business financing. Corning Credit Union works well with people and their representatives have a great attitude. They're very easy to work with. When people need loans, they often need a swift response. Banks have time-consuming application and approval processes that are difficult for people to navigate, but CCU moves quickly and smoothly to help businesses with financing.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

arin L Walter 9-16-11

Arin Walter, Owner
Arin's Auto

September 16, 2011

Dear Representative:

My name is George Martinec, and I am the Owner/President of Martinec Building and Remodeling operating in Big Flats, NY. I am writing to ask for your support to lift the member business lending cap for credit unions.

My business is just one of the many in New York that depends on credit unions for business loans. We need more access to business loans, not less, in order to grow, expand and positively impact New York's economy.

As a member of the Corning Federal Credit Union, I believe that the greatest asset to a credit union is that it is owned by its members. It has strong local roots and community ties. It is more responsive compared with large national banks, which are very difficult to work with. Quick, straight-forward access to loans and credit is essential and that access can have a huge impact on my business and employees. We've been able to expand our business with loans and a line of credit we received through the Corning Credit Union. That adds a lot of security during this time of recession, when we need to keep our business open and our employees and families working and earning. Our relationship with Corning Credit Union remains a very positive one, largely because the credit union really works hard to establish and maintain that relationship. Business owners really respond to that. The rapport the credit union cultivates with its small business owners facilitates our financial business dealings. For these and innumerable other reasons, I believe this legislation to increase the credit union lending cap should be supported.

My fellow credit union business members and I are counting on you to help New York's small businesses by leading the effort to raise the cap on credit union business lending.

Thank you for your consideration of a widely beneficial resolution to this issue.

Sincerely,

George Martinec, Owner/President
Martinec Building and Remodeling