



Credit Union National Association

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## **LEGISLATIVE BRIEFING PAPER**

### **CREDIT UNIONS ARE THE BEST WAY FOR CONSUMERS TO CONDUCT THEIR FINANCIAL SERVICES**

Credit unions are not-for-profit financial cooperatives. Overall, nearly 92 million U.S. consumers are member-owners of, and receive all or part of their financial services from the nation's 7,600 credit unions. Credit unions are a small, but constant and stable presence in the financial services industry. Credit unions hold about 6.7% of household financial assets, up from about 5.5% in two decades.

As democratically owned and controlled institutions, credit unions take pride in their "people helping people" philosophy. Credit union boards of directors are elected by members; each member has an equal vote, regardless of how much he or she has on deposit. Credit unions have no outside stockholders, so after reserves are set aside, earnings are returned to members in the form of dividends on savings, lower loan rates or additional services. Because a credit union is in business to serve its members – and not to make profit for anonymous stockholders – credit unions provide superior member service and consistently rank first among financial institutions in consumer satisfaction.

Credit unions primarily engage in consumer, residential real estate and small business lending with their members. Credit unions did not engage in the activity that caused the financial crisis, and they did not need to be bailed out, like for-profit banks. While credit unions were affected by the crisis, credit union asset quality remains very high in the current shaky market with first mortgage delinquencies at 2.3% and overall loan delinquencies at 1.75% at the end of 2010. Credit union capital is equal to 10.1% of total assets (far above the 7% regulatory minimum to be considered "well capitalized").

#### **All Consumers Benefit by Having Credit Unions in the Marketplace**

##### **Benefits to Credit Union Members**

- **Lower interest rates and fees than for-profit banks**
- **Higher rates of return on deposits than for-profit banks**
- **One member, one vote gives credit union members a voice in credit union operations**
- **Great service from a financial institution that exists to serve members, not enrich shareholders.**

##### **Benefits to All Consumers**

- **The presence of credit unions in a market motivates banks to keep their rates and fees competitive, benefiting all consumers.**
- **Credit unions provide stability to the financial industry.**
- **Credit unions did not need a taxpayer bailout because the not-for-profit structure discourages excessive risk-taking.**



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# The Credit Union Value Proposition

## Did You Know?

- Congress has provided the credit union federal tax-exemption because of the not-for-profit, cooperative structure of credit unions, and the special mission credit unions have to serve consumers.
- The credit union tax status is not based on the size of credit unions or the products and services that they offer; **it is based on the credit union structure.**
- This rationale for the tax-exempt status has been ratified several times by Congress.

## Our Ask:

- Members of Congress should be outspoken in their support for the credit union tax status, and should not use the tax status as a mechanism to prevent improvements to the Federal Credit Union Act.

## What are the Policy Implications?

- There is no hiding the fact that the Federal government faces a significant budget crisis. A Presidential Commission recently recommended eliminating all tax expenditures.
- The credit union tax status benefits all consumers – credit union members and those who are not credit union members. While the credit union tax expenditure “costs” the federal government approximately **\$600 million** annually, consumers benefit to the tune of **\$10 billion** annually because credit unions are tax-exempt.
- Credit union competition helps keep bank savings rates higher and loan prices lower. For example, credit unions offering credit cards now charge lower interest rates than most other lenders (on average by two or three percentage points). Imagine how expensive other lenders would make credit cards, or auto loans, if credit union competition did not exist!
- Further, the existence of credit unions in the marketplace provides consumers with access to consumer-friendly financial services. If credit unions were taxed, product pricing would increase, and, as a result, there would be little incentive for a cooperative-financial institution to exist. This would leave low to moderate income consumers seeking financial services either at for-profit banks (more expensive products) or predatory lenders. The motives of credit unions are different because they are not-for-profit. Credit unions are in business for their members, not to make profits for anonymous shareholders.

## What are the Implications for Credit Unions?

- **Eliminating the credit union tax status eliminates credit unions.** It is that simple, and given what our economy has just been through, that would be a shame for consumers.
  - Even though credit unions were affected by the financial crisis, none of the problems that precipitated the crisis were caused by credit unions. This is because the motives of credit unions and the incentive structures are different from for-profit financial institutions. If credit unions are taxed, there is no incentive for credit unions to remain not-for-profit; they will convert to banks; and our economy will lose the only sector of the financial industry that is not driven by profit, but rather driven by a dedication to serve its members.
  - Credit unions are people helping people; unlike the banks, they are not people using people to generate profits for shareholders.
- Credit unions are the best way for consumers to conduct their financial services. Taxing credit unions takes this option away from consumers, and will drive up the cost of financial services for all.

# Credit Union Small Businesses Lending

## Did You Know?

- Credit unions have been making member-business loans (MBLs) since their inception in the early 1900s. In the first 90 years of their existence, there was no MBL cap on credit unions. The current cap is an arbitrary limit imposed by Congress in the Credit Union Membership Access Act of 1998 (CUMAA).
- In the next year, credit unions business lending could increase over \$13 billion, helping small businesses create over 140,000 new jobs if Congress increases the statutory cap on credit union business lending. This can be done without costing the taxpayers a dime and without increasing the size of government. Unlike banks, credit unions do not need taxpayer assistance to encourage them to do more business lending; credit unions only need authority from Congress.

## Our Ask:

- Congress should enact legislation (S. 509/H.R. 1418) to provide a taxpayer-free infusion of \$13 billion in capital to small businesses to create 140,000 jobs nationally, by increasing the credit union lending cap to 27.5%. This approach has been endorsed by the Obama administration.

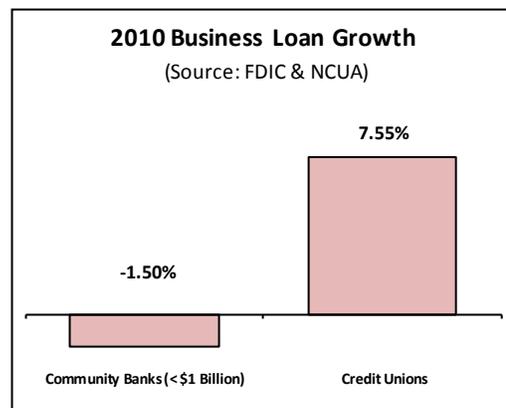
## What are the Policy Issues?

- America's small businesses are the engine of growth of our nation's economy. The effects of the financial crisis of the past few years have spread to all types of lending, resulting in a reduction in the availability of business credit.
- Unemployment remains high, at 9.2%. America's small businesses could create jobs, if they are given access to capital. Credit unions can provide them with \$13 billion in capital.
- The cap on credit union member business lending (currently 12.25% of the total assets of the credit union) has no economic, safety and soundness or historical rationale. In fact, credit unions have been lending to their business-owning members for a century. Additionally, credit union loan losses (net charge off rates) for business loans are much lower than those for business loans made by banks.
- At a time when banks are withdrawing credit from America's small businesses, credit unions have actually been expanding credit to small businesses, but with more credit unions approaching the cap, this growth is threatened. It makes economic sense to permit credit unions to lend additional capital to their business-owning members.

## What are the Implications for Small Businesses?

- The average credit union business loan is approximately \$220,000. Therefore, when a credit union lends to one of its business-owning members, the capital can be used to keep the business competitive and hire additional employees – up to 140,000 people nationally.

Banks have been reducing credit availability, and even after receiving \$30 billion of taxpayer money, banks still are not meeting the demand for small business loans. Credit unions have a strong history of better lending, and will do better than the banks' failed efforts to help small businesses, all without any cost to



the taxpayer.

## Credit Unions Are Vital Participants in the Housing Finance Market

### Did You Know?

- Credit unions are increasingly important players in the residential mortgage market, originating approximately 6% of all first mortgages. Since 2007, credit unions have originated over a quarter of a trillion dollars in residential first mortgages.
- Credit unions have traditionally been portfolio lenders, typically selling between 25%-40% of their originations; however over the last two years, credit unions have sold over half of their new loans to the secondary market. Credit unions rely on a functioning secondary mortgage market.

### Our Ask:

- As Congress considers comprehensive housing finance reform, it is imperative that the new system facilitate credit union lending so that credit unions may continue to be a source of reliable mortgage credit for their members.

### What are the Policy Issues?

- The federal government has a very important role to ensure the secondary market operates efficiently, effectively and fairly for borrowers and lenders alike. Credit unions have some concern about a world in which the secondary mortgage market is occupied by a handful of very large banks.
- The following principles are important to consider as comprehensive housing finance proposals are developed.
  - Equal Access: The secondary market must be open to lenders of all sizes on an equitable basis.
  - Strong Oversight and Supervision: There should be appropriate regulatory oversight to ensure safety and soundness, including strong capital requirements.
  - Durability: The new system should ensure that mortgage loans will continue to be made to qualified borrowers even in troubled economic times.
  - Preservation of the 30-year fixed rate mortgage: This product is the centerpiece of the mortgage lending market and the new system should facilitate its availability to qualified borrowers.
  - Affordable Housing: The important role of government support for affordable housing should be a function separate from the responsibility of secondary market entities.
  - Transition: The transition to the new housing finance system must be reasonable and orderly.

### What are the Implications for Credit Unions?

- Mortgage lending is a significant activity for many credit unions and is a vital financial service for their members. Reform of the housing finance system will be difficult, but failing to make necessary changes to improve the system will result in even greater challenges for the economy, credit unions, and borrowers.
- If changes are made which create barriers to credit union access to the secondary market or which disrupt the currently fragile market, the mortgage lending needs of credit union members and other consumers may not be met.

# The Need for Supplemental Capital

## Did You Know?

- Credit unions remain the most highly regulated and restricted of all insured financial institutions and stand out as the only depository institutions in the United States without the ability to issue some form of capital instruments to augment retained earnings to build capital.
- Credit unions historically have had the lowest default/delinquency rates in virtually all categories of loans and have maintained average net worth ratios well in excess of those held by banks.
- By law – not regulation, as is the case for other insured depositories – credit unions must maintain a 7% net worth (or leverage) ratio in order to be considered “well capitalized.” The law also specifies that only retained earnings constitute net worth for credit unions.
- All other U.S. depository institutions and most credit unions in other countries are permitted various forms of alternate or supplemental capital.
- The National Credit Union Administration recently wrote Senate Banking Committee Chairman Johnson and House Financial Services Committee Chairman Bachus to encourage them to address credit union capital issues.

## Our Ask:

- Congress should modify the definition of credit union net worth to include supplemental forms of capital for credit unions.

## What are the Policy Implications?

- The recent financial crisis led to a substantial drop in the average credit union capital ratio – from 11.4% at the end of 2007 to 10.1% as of the end of 2010. At the beginning of the downturn, 90% of credit unions had net worth ratios of 9% or greater. At the end of 2010, only about 75% of credit unions had this level of capital.
- While the credit union movement as a whole remains very well capitalized, a number of credit unions are close to or past the prompt corrective action (PCA) triggers as a result of the financial crisis. These credit unions will need to raise capital at a time when the outlook for credit union net income – the source of retained earnings – is not particularly strong.
- Long term influences on credit union net income are not promising. Net interest income, essentially the difference between what credit unions earn in interest on loans and investments and what they pay in interest and dividends on savings has been on a long-term downtrend caused by intense competition on both sides of the balance sheet. This pressure is unlikely to abate significantly going forward. In addition, interchange income, an important source of non-interest revenue, is under political pressure and is likely to diminish.

## What are the Implications for Credit Unions?

- Capital is king for all financial institutions. As credit unions battered by the financial crisis recover in the coming few years, rebuilding capital ratios will be paramount.
- **Without access to supplemental capital, and with earnings power facing headwinds, credit unions and their members will face a protracted period of reduced member service, disadvantageous member pricing, and very slow growth, unless Congress allows credit unions to access supplemental forms of capital.**
- Supplemental credit union capital will reinforce and strengthen the regulatory incentive for credit unions to remain exceptionally safe and sound, and, will allow credit unions to do even more to serve all their members. This would benefit **all** credit unions whether they use the authority or not.