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CREDIT UNIONS: MEMBER BUSINESS LENDING

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXAMINING THE ISSUE OF CREDIT UNION MEMBER BUSINESS LENDING

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C O N T E N T S

THURSDAY, JUNE 16, 2011

	Page
Opening statement of Chairman Johnson	1
Prepared statement	24
Opening statements, comments, or prepared statements of:	
Senator Shelby	
Prepared statement	24
Senator Schumer	
Prepared statement	25

WITNESSES

Deborah Matz, Chairman, National Credit Union Administration	2
Prepared statement	26
Responses to written questions of:	
Senator Merkley	95
Bill Cheney, President and Chief Executive Officer, Credit Union National Association	10
Prepared statement	47
Responses to written questions of:	
Senator Merkley	97
Noah Wilcox, President and Chief Executive Officer, Grand Rapids State Bank, on behalf of Independent Community Bankers of America	12
Prepared statement	81
Responses to written questions of:	
Senator Merkley	97
Michael Lussier, President and Chief Executive Officer, Webster First Federal Credit Union, on behalf of the National Association of Federal Credit Unions	14
Prepared statement	84
Responses to written questions of:	
Senator Merkley	98
Stephen P. Wilson, Chairman and Chief Executive Officer, LCNB National Bank, on behalf of the American Bankers Association	16
Prepared statement	88
Responses to written questions of:	
Senator Merkley	98

Additional Material Supplied for the Record

Letter submitted by Paul Hazen, President and Chief Executive Officer, National Cooperative Business Association	99

CREDIT UNIONS: MEMBER BUSINESS LENDING

THURSDAY, JUNE 16, 2011

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:09 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. Good morning. I want to welcome and thank our witnesses for being here today to testify on the issue of credit union member business lending. While we wait for the Ranking Member to make his appearance, I will go ahead and start.

Under the Federal Credit Union Act, credit unions are limited in the amount of business lending they are permitted to engage in. 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 percent of the credit union's total assets. The member business lending cap was put in place in 1988 with the passage by Congress of the Credit Union Membership Access Act. Since that time, the credit union industry has advocated for a removal of or an increase in the business lending cap. Senator Mark Udall has introduced legislation that would raise the cap to 27.5 percent of total assets.

There is a wide range of views on this matter, especially as Congress considers proposals to speed the economic recovery. I think that it is important that we take the time to examine this issue here in the Committee and provide the opportunity for all sides to fully express their views on this subject. I look forward to your testimony, Chairman Matz, to our other witnesses' testimony, and to the question-and-answer period.

I see there are not any other Members present.

Debbie Matz has been the Chairman of the National Credit Union Administration since August of 2009. Prior to her appointment, she was the executive vice president and chief operating officer of Andrews Federal Credit Union of Suitland, Maryland. Chairman Matz has also served as a board member at NCUA from January 2002 to October 2005.

Chairman Matz, welcome and please proceed.

STATEMENT OF THE DEBORAH MATZ, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Ms. MATZ. Thank you, Chairman Johnson. I appreciate this opportunity to discuss credit union member business lending legislation, regulation and supervision, and the significance of such lending for small businesses.

Credit unions have always offered member business loans. In the industry's early days, business loans primarily supported agriculture. But over time, business lending has evolved, changing with the needs of entrepreneurs who deserve greater, not fewer, affordable credit options. Today credit unions have more than 167,000 outstanding loans to businesses.

As a starting point, I see three tangible benefits provided by credit union member business lending:

First, it allows small businesses to obtain reasonably priced loans. Simply put, more competition benefits the entire marketplace and has a positive effect on the cost and availability of credit.

Second, prudent member business lending strengthens a credit union's balance sheet. It diversifies credit union portfolios and 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 a unique set of risks and requires specialized rules and oversight. Our experience has shown that, to succeed, credit unions making loans to small businesses need to be aware of cash-flow, portfolio management and liability issues, to name just a few.

In response, NCUA has tailored rules to emphasize sound underwriting, solid collateral and tested management. These criteria form the foundation of prudent lending. NCUA has taken great care to ensure that our rules keep pace with the evolving marketplace.

Like other types of loans, member business loan performance is cyclical. Recent member business lending trends reflect the financial stress of 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 to 3.76 percent.

While member business loan delinquencies and charge-offs increased during the recent economic downturn, those increases primarily resulted from the severe decline in real estate values in the five sand States: Arizona, California, Florida, Nevada, and Utah. Forty percent of all delinquencies and 49 percent of all charge-offs are isolated in these five States.

Nationwide, more than 2,100 credit unions make member business loans. This figure has risen nearly 10 percent since 2006 despite the economic downturn. While nearly 30 percent of credit unions underwrite business loans, these loans comprise just 1 percent of all commercial lending.

However, these statistics do not capture the fact that credit union member business lending serves an important segment of the marketplace: small businesses and entrepreneurs. The average member business loan is only $223,000. Of course, this average represents a wide range of loans for a variety of business purposes.

On the whole, credit union loans tend to be much smaller than other business lenders. For example, credit union loans for commercial and industrial purposes, such as building and equipment, averaged just $127,000. By comparison, bank loans for commercial and industrial purposes averaged $643,000—more than 5 times larger than the credit union average.

To expand credit union service to the business community, Senator Mark Udall has proposed legislation, S. 509, to increase the permissible level of member business lending from 12.25 percent of assets to 27.5 percent for credit unions meeting high standards. The bill's tiered approach would allow healthy, well-capitalized credit unions to increase business loans in small, manageable increments.

These credit unions, however, must first meet stringent standards that place a premium on experience and a proven track record of successful management.

Let me assure you, if legislative changes increase the current cap, NCUA would promptly revise our regulations to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns. NCUA would also remain vigilant in carrying out its supervisory authorities with respect to such legislative changes.

The proposed legislation together with a responsible regulatory approach would provide credit unions the opportunity to prudently grow their business loan portfolios. In so doing, credit unions would increase the diversity in their overall loan portfolios, thus reducing concentration risk.

NCUA regulations require any credit union that is less than adequately capitalized to suspend business lending. I am pleased that S. 509 would adopt a similar safeguard.

In sum, S. 509 is a well-conceived, balanced approach to making more capital available to small businesses while ensuring that these loans are made in a prudent manner, consistent with each credit union's capabilities.

Entrepreneurs work hard, take risks, and put people to work. To fulfill their dreams, they need capital. Credit unions have long met the capital needs of small businesses. Credit unions are frequently the only lenders willing to make small loans to open a car repair shop, expand a boutique, or start a day-care center. The capital provided to hard-working Americans enriches lives, provides employment, and reinforces the economic base of communities.

S. 509 would permit credit unions to empower more enterprising individuals and meet the needs of more small businesses that are expanding and creating jobs and opportunities for their communities.

Thank you, and I look forward to your questions.

Chairman JOHNSON. Thank you, Chairman Matz.

Members will have 5 minutes for questions.

Chairman Matz, when you testified before the Committee in December, your written testimony indicated that the levels of delinquent member business loans and charge-offs have increased. You also noted an increasing number of large credit unions about which the NCUA has supervisory concerns where MBLs are the primary or secondary contributing factor with a supervisory concern.

Given these concerns, why do you believe that it is prudent to increase the member business lending done by credit unions?

Ms. MATZ. Thank you. Member business lending does have higher delinquency and charge-offs than other consumer loans. But, in fact, in the last quarter, the delinquencies have started to decline. And because delinquencies lead the charge-offs, we are looking forward to a decline in charge-offs, as well.

But I should point out that if a credit union has delinquent loans, that does not necessarily result in a loss. Even the charge-offs do not necessarily result in a loss if they are well capitalized. So they can have delinquencies and charge-offs and still not suffer a loss, if the loans were well collateralized. That is part of our supervision to make sure that they are.

But in terms of actual losses, there are about 2,200 credit unions making business loans right now. In 2008 and 2009, we only had one credit union failure that was primarily attributable to member business lending. So, member business lending is being done prudently, by and large, and we are supervising member business lending in those credit unions that engage in business lending very carefully to make sure that they have experienced staff and that they are underwriting properly.

Chairman JOHNSON. Chairman Matz, Senator Udall's legislation would require that the NCUA develop a tiered approval process by which a credit union gradually increases the amount of member business lending it engages in. Have you given any thought as to what the tiered process might look like and how you might implement it?

Ms. MATZ. Yes. The tiered process will be very helpful in terms of increasing our supervisory ability and ensuring safety and soundness because credit unions will still be able to make loans up to 12.25 percent of assets, but to get above that, they will have to meet stringent guidelines. They will have to have made business loans for at least 5 years. They will have to be well capitalized and well managed. And they will have to be at or above 80 percent of the cap.

But we will come behind that with regulations to ensure that even above and beyond that, that the credit unions that go above the cap do so in a moderate way, that they crawl before they walk. So, we will not necessarily let them go up to 30 percent of an increase in 1 year. We will probably have regulations that modify that and let them increase more gradually than that.

Chairman JOHNSON. Witnesses on the second panel suggest that credit unions are making loans that banks have previously turned down. Is that the case? And if so, are you as a regulator concerned about the safety and soundness of such loans?

Ms. MATZ. Well, from what I hear—and it is anecdotal—credit unions sometimes do make loans that banks have turned down. But, my understanding is it is based on the size of the loan and the use of the loan, because what I am told is that very small businesses that need small loans do not have access—frequently do not have access to banks, and so they come to credit unions.

A credit union average loan is only $223,000, and that average, of course, includes much larger loans. So, in fact, the median is closer to $127,000. These are very small loans, so I am not concerned about the risky nature. As long as the credit unions are prudently underwriting the loans. I am not concerned that they are approving loans that banks have turned down, because I do believe that by and large it is based on the size of the loan and not the risky nature of the loan.

Chairman JOHNSON. I have an additional question. Member business loans often have higher delinquency rates than other types of loans. It, therefore, seems counterintuitive for the potential regulator to support legislation to increase the member business lending cap. Would you provide more details about why you support the Udall bill and why you believe that the Committee should not view this legislation as a risk?

Ms. MATZ. Thank you. That is a good question because it does seem counterintuitive that a regulator who is extremely concerned about safety and soundness—and, in fact, that really is my sole—almost exclusively my focus—would support legislation to raise the cap. But, in fact, I believe that raising the cap will enhance safety and soundness because the low cap at 12.25 percent is artificially low. There are a number of credit unions that would like to get into business lending but do not because they do not feel that they will be able to recover their investment. But, in fact, business lending would help diversify their portfolio.

Now credit unions are probably overconcentrated in mortgage loans, and they also have a lot of car loans, and so I view business lending as an opportunity to diversify their portfolios and to reduce the concentration of risk in their portfolio, and certainly to reduce the interest rate risk which they have from long-term mortgages. So I view it as a safety and soundness benefit, not as increasing the risk.

Chairman JOHNSON. Chairman Matz, what percentage of credit unions are currently at the limit and, therefore, constrained by the statutory cap?

Ms. MATZ. There is a very small number that are at or near the limit. It is under 300 credit unions that are at or near the limit.

Chairman JOHNSON. Out of how many credit unions?

Ms. MATZ. Out of about 7,300 credit unions. It is a very small number, but it is misleading because the cap constrains all credit unions.

There are so many credit unions that are not making business loans because of the cap even though they are not near it. They just do not want to make the investment, and even some credit unions that are making business loans do not really market it. They will make business loans to people who walk in the door, members who walk in the door and ask for them, but they do not market it because they do not want to be in a position to have to turn away customers once they get close to the cap.

Chairman JOHNSON. Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and thank you, Chairman Matz, for being here. I have got something a little off topic and then something on topic.

Off topic—it is easy for you—is whether you might talk a little bit about how our credit unions fared during this economic crisis that we just went through and are sort of slowly climbing out of. Could you give us a sense of their experience in this period of time?

Ms. MATZ. Certainly, and I will divide that answer into two parts—the corporate credit unions and the retail or the consumer credit unions.

The corporate credit unions had a large concentration of mortgage-backed securities on their books. As a result, when the bond market collapsed, the value of those bonds collapsed. We had to place five of those corporate credit unions into conservatorship, and it has been a significant crisis that we are leading the credit unions out of. We have put into place much stronger rules governing corporate credit unions, and at this point the corporate system is stabilized. We are beginning to feel like we have seen the worst of the corporate situation.

Right now credit unions are at the point of deciding whether to recapitalize the corporate credit unions, and we will know that by September. At that point credit unions will either get their liquidity and their payment processing through corporates or elsewhere. September is the deadline. But we are on track, and it has been very effective. There has been no interruption of service. Payment systems have been effective, and so we are coming out of that. We learned a lot of lessons, and as a result we have significantly changed the rules governing corporate credit unions.

The retail or consumer credit unions are also beginning to show signs of recovery. The first quarter data for the credit unions showed very positive indicators that net worth is up and their assets continue to rise. Their delinquencies have started to trend down, and so it has been a difficult time, but through it all credit unions have continued to lend. From 2007 to 2010, lending increased 6 percent, so it is modest. It is down from where it was, but they are still continuing to lend. So, I am optimistic that the problems have bottomed out and that they are starting to recover.

Senator BENNET. Thank you for that. If Congress did increase the cap on member loans—you just testified that only about 300, I think, credit unions are close to the cap. How many credit unions do you think would take advantage of that? Are there some—you have just talked about the distinction between corporate and consumer. Are there certain kinds that you would expect to be in the business before others? How do you see this going if we did this?

Ms. MATZ. Well, I would think that larger credit unions that are well capitalized—and by that, I mean credit unions that are probably from 50 million and up, or maybe even 100 million and up—would be more likely to start making business loans. There are also those that are making business loans that would be inclined to expand it. As I said previously, credit unions tend not to market the business loans because of the cap, so if the cap were raised, they would be more likely to market it and to make more loans. But there are probably about 2,000 credit unions that are over 50 million in assets that would be more likely to take advantage of this if the cap were raised.

Senator BENNET. Thank you, Mr. Chairman. Thank you.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairlady, how are you?

Ms. MATZ. Good. Good to see you.

Senator MENENDEZ. Good to see you. You know I have been a strong supporter of the credit unions, but I think there are some serious questions here. How is it—we will hear from the next panel, but I just want to look at a couple of the arguments they are presenting and get your sense of it. One is that they will say that this legislation would allow a new breed of credit union institutions to more aggressively pursue business customers through large commercial and real estate loans. It would also serve as an invitation to credit unions that are not near this cap now to focus on business lending to the exclusion, or greater limitation—that is my add-on—of consumer lending in order to be eligible for an increase in their business lending cap. Are you concerned about that?

Ms. MATZ. Well, I think that it would be an opportunity for credit unions to expand their business portfolio, but the loan-to-share ratio of credit unions is in the high 60s, maybe about 68 percent. So, there is still a great deal of capacity for credit unions to expand business lending and still meet the needs of consumers.

Senator MENENDEZ. What about the fact that credit unions by their nature are tax exempt and obviously do not live within all of the regulatory requirements that banking institutions live under, if we expand the nature of their portfolio, the arguments that you have an uncompetitive process because they are tax exempt and because they are not subject to all the regulatory requirements that a banking institution doing similar transactions would be subject to? Is that not a fair criticism?

Ms. MATZ. Credit unions are more stringently regulated than banks as far as business lending. In fact, in 2001, the Treasury Department did a study of credit union member business lending, and they said they found no evidence that credit union business lending would adversely impact banks. In fact, that study found they would increase the competition with small banks and the benefit would go to the consumer. So, you know, whether credit unions are tax exempt is not something I deal with. I deal with safety and soundness issues. But credit unions are very tightly regulated in terms of making business loans or any loans.

Senator MENENDEZ. But they are certainly not regulated to the same extent that banks are. For example, they do not have the community reinvestment responsibilities that banks have.

Ms. MATZ. No, they do not. Credit unions have fields of membership, and so they can only serve people in their field of membership.

Senator MENENDEZ. Right. So the question is: What would you do if we were to pass this law? How would you go about deciding whether it is OK for a credit union to increase its member business lending? And if you had to approve applications for that, what is the criteria you would use?

Ms. MATZ. Well, we do our exams and they are based on safety and soundness. If a credit union has experienced commercial lending staff in place and it is a well-managed credit union and it is well capitalized, those are the types of issues that we would look at.

Senator MENENDEZ. But right now they have, what, very little commercial—other than, you know, auto loans and maybe real estate?

Ms. MATZ. There are 2,200 credit unions that make business loans.

Senator MENENDEZ. That make business loans.

Ms. MATZ. Yes.

Senator MENENDEZ. OK. So that is the universe that would more likely be up for the possibility?

Ms. MATZ. Well, I think it would be more than that. I think there are credit unions that are not making business lending because of the cap that likely would start making those loans. Right now, credit unions, I am told, are reluctant to get into the business lending business in some cases because they feel that they will not get a return on their investment because of the cap. It is a sizable investment in terms of the staff and the infrastructure that needs to be put in place.

Senator MENENDEZ. So then on the two questions, you are saying that if we were to do this, you are not concerned about consumer lending being squeezed out as a result of the credit unions' seeking more of the business lending, and you are not concerned about overall risk as it relates to taking on an expanded portfolio in this regard to the credit unions?

Ms. MATZ. No, I am not.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman. Mr. Chairman, I was detained earlier. I ask unanimous consent that my opening statement, a lengthy one, be made part of the record.

Chairman JOHNSON. It will be received.

Senator SHELBY. Thank you, Mr. Chairman.

Senator SHELBY. Chairman Matz, I am sorry I was not here earlier.

Ms. MATZ. That is quite OK.

Senator SHELBY. Congress, as I understand it, originally imposed business lending limitations in order to limit excessive risk taking—you may have gotten into this. I am not sure; I was not here—by credit unions. Do you believe that a higher cap on business lending would adversely impact the safety and soundness of credit unions? And how would increasing the lending limit impact the National Credit Union Share Insurance Fund?

Ms. MATZ. I do not believe that increasing the cap would adversely impact safety and soundness, and as counterintuitive as it might seem, I think it would have a positive——

Senator SHELBY. If not, why not?

Ms. MATZ. I think it would have a positive impact on safety and soundness because right now credit unions have a very large book of business in mortgages and in auto loans. As we learned from this recent economic downturn, concentrations are not good for financial institution portfolios. So, being able to add business loans——

Senator SHELBY. By concentration, you mean concentrating in one product?

Ms. MATZ. Correct. Being able to add business loans to the portfolio would actually diversify the portfolio, reduce the concentration and, in my opinion, enhance the safety and soundness.

Senator SHELBY. Of the 55 credit unions that failed during 2009 and 2010, twenty underwrote business loans at the time of their failure. What role did business lending play in the failure of these credit unions? And how did the amount and nature of the business loans made by these failed institutions compare to those made by healthy credit unions? I know you have gone back and looked at this.

Ms. MATZ. Yes. In fact, during that period of time that you mentioned, there was only one credit union that failed directly as a result of business lending out of the 2,200 credit unions that make business loans. There were 55 failures in that time, and of those, 20 made business loans, but the business loans——

Senator SHELBY. Because there were a lot more failures of banks. We know that.

Ms. MATZ. Yes.

Senator SHELBY. During that time.

Ms. MATZ. There were a lot more failures of banks. There were only 55 credit union failures in that time.

Senator SHELBY. OK. In your testimony today, you stated that 70 percent of all credit unions do not engage in any business lending. In addition, you noted that only about 7 percent of credit unions are close to the cap on business lending. Of these few credit unions, nearly two-thirds have assets of over $500 million, half a billion dollars. Which types of credit unions would benefit the most from an increase in the cap? In other words, large credit unions or small credit unions? Or do you have any evidence that you can share with the Committee that increasing the cap would benefit small credit unions? We have a lot of small credit unions.

Ms. MATZ. Well, I would say that the credit unions that would benefit the most are probably the ones that are over $50 million. The ones that are $50 to $100 million, almost half of them are making business loans. For the other categories, $100 million and above, it is a majority of the credit unions. So I would say the credit unions most likely to make business loans are over $50 million.

Senator SHELBY. When testifying before this Committee last year, which was just a few months ago, you noted that for those credit unions that engaged in business lending then and had poor CAMELS rating, often the business loans wee responsible for the low ratings, according to what you testified. How can business loans get a credit union into trouble? Or how can they avoid trouble, so to speak? And should a credit union be required to have a high CAMELS rating before its cap on business lending can be increased? In other words, we are interested in the safety and soundness of all these institutions.

Ms. MATZ. Answering the second part first, yes, I think that they should have—particularly on the management, the "M" in the CAMEL, I think that they should have a high CAMEL rating in order to go beyond the bottom tier, and——

Senator SHELBY. Well, that is just common sense for safety and soundness, isn't it?

Ms. MATZ. Yes. And if this legislation is passed, we will quickly implement a new set of regulations to implement the statute, and most likely that will be one of the things that we include in it.

Senator SHELBY. What is your estimate or your judgment on the number of credit unions that are currently not making any business loans but will start to make business loans if the cap is increased? Do you have a number on that, roughly?

Ms. MATZ. Well, there are about 6,000 credit unions that are not exempt from the cap. There are about 1,200 that are exempt from the cap for one reason or another. And of the 6,000, probably 4,000 of them are under $50 million. So, probably 2,000, or 2,200 probably benefit from it if they chose to.

Senator SHELBY. How much would the business lending cap have to increase to basically make it cost-effective for small credit unions to engage in business lending? Have you done any work in that area?

Ms. MATZ. No, I do not know the answer to that, but for small credit unions, they—there are small credit unions that engage in business lending, and frequently it is done through participation in a loan or through a credit union service organization rather than doing it themselves.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Chairman Matz.

Now I would like to welcome the witnesses for our second panel.

Mr. Bill Cheney is president and CEO of the Credit Union National Association, which represents most of the Nation's nearly 7,800 credit unions. Mr. Cheney became president and CEO of CUNA in July 2010 following nearly a quarter century's experience in the credit union movement.

Mr. Noah Wilcox is president and CEO of Grand Rapids State Bank. He is also a director and member of the executive committee of the Independent Community Bankers of America.

Mr. Michael Lussier is president and CEO of Webster First Federal Credit Union and is also the chairman of the board of the National Association of Federal Credit Unions and has over 25 years of banking and credit union experience.

Mr. Stephen Wilson is chairman and CEO of LCNB National Bank. He is also the recently elected chairman of the American Bankers Association.

I thank all of you again for being here today, and I look forward to your testimony. I will ask the witnesses to limit your remarks to 5 minutes. Your written statements will be submitted for the record.

Mr. Cheney, would you like to begin?

STATEMENT OF BILL CHENEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CREDIT UNION NATIONAL ASSOCIATION

Mr. CHENEY. Yes, Mr. Chairman, Ranking Member Shelby, Members of the Committee, thank you very much for calling today's hearing on credit union member business lending.

Although credit unions weathered the financial crisis well, the economy as a whole is struggling. As everyone agrees, more needs to be done to help America's small businesses create jobs. Credit unions can help if Congress enacts S. 509, Senator Mark Udall's Small Business Lending Enhancement Act. This much-needed, commonsense legislation would increase the statutory member business lending cap from 12.25 percent of a credit union's assets to 27.5 percent and impose statutory and regulatory safeguards on the increased lending to protect the Share Insurance Fund from additional risk. These safeguards were designed by Treasury and the NCUA. If this legislation is enacted, we estimate that credit unions could lend an additional $13 billion to their members who own small businesses in the first year, helping them to create $140,000 new jobs without an outlay of a single taxpayer dollar.

As my written testimony describes, credit unions have continued to lend to their members throughout the financial crisis, increasing their business lending portfolio by 38 percent since 2007, while the banks' commercial loan portfolio shrank by 5 percent. Currently there are over 330 credit unions near the cap, and they account for over half of the business loans subject to the cap. These credit unions have been the source of most of the growth of credit union business lending. Over the next few years, the growth among these credit unions will dry up without an increase in the cap, and that would be bad for America's small businesses.

The Udall bill establishes a two-tiered structure for credit union member business lending. Tier One credit unions would be eligible to engage in business lending up to the current limit. Tier Two credit unions would have to meet even more statutory and regulatory criteria and be approved by NCUA, and only then would they be permitted to engage in additional business lending. The Udall bill would permit credit unions to help small businesses in need of credit while at the same time ensuring that credit unions engaging in additional business lending would do so in a safe and sound manner.

It is hard to believe that the Government is telling credit unions they cannot help create jobs in their local communities. There is really just one reason why. The banks oppose it. This answer does not satisfy the small business owner who has been turned down for a loan by multiple banks; it should not satisfy Congress. It should satisfy no one.

There are at least 140,000 reasons to let credit unions do more small business lending, and there are no sound public policy reasons not to. Failure to expand the credit union member business lending cap would literally leave money on the table that could be loaned to small businesses to create jobs.

The bankers say business lending is not a part of the credit union mission, but credit unions have been doing member business lending since day one. The bankers say increased business lending would undermine credit union safety and soundness, but credit unions do this type of lending more safely and soundly than banks.

The bankers say increasing the cap would only affect a small number of credit unions while at the same time claiming that increasing the cap will hurt community banks. It is a contradiction, and the bankers are wrong on both counts. Increasing the cap will have a profound effect on the hundreds of credit unions that will reach the cap in the next few years, but it will not adversely affect the banker dominance of the small commercial loan market, currently at 95 percent. In fact, credit union member business lending actually helps local communities, including community banks, by stabilizing the local economy and creating jobs.

The bankers say that increased credit union business lending will lead to a reduction of other types of credit union lending, but most credit unions have plenty of liquidity to fund the increase.

The bankers say that credit unions should not be granted an expansion of powers because of their tax status. This argument is disingenuous when one-third of all banks are exempt from Federal income tax as Subchapter S corporations. The credit union tax status is based on the not-for-profit cooperative structure of credit unions, not credit union powers.

The bankers say that increased business lending calls into question the credit union industry's commitment to serve the underserved, yet the credit union record of serving the underserved is well demonstrated. And when we have attempted to do more to serve the underserved, the bankers have brought lawsuits to stop us.

As we recover from the Great Recession, small businesses are underserved, yet the bankers say that small business credit is not in short supply. But many small business owners report being turned away by their banks. It is a primary reason that Congress gave the banks access to 30 billion taxpayer dollars last year. Their lending is down. Our lending is up. There must be demand in the market if our lending is increasing.

Credit unions want to meet the demands of their business-owning members. The time is now to set aside the false and misleading banker rhetoric. We urge Congress to permit credit unions to do what they were established to do—serve their members, including those who own small businesses. We have the willingness to help. We have the capacity to help. But we need Congress to enact the Udall bill as supported by Treasury and the NCUA.

Mr. Chairman, thank you very much for the opportunity to testify. I look forward to your questions.

Chairman JOHNSON. Thank you, Mr. Cheney.

Mr. Wilcox.

STATEMENT OF NOAH WILCOX, PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRAND RAPIDS STATE BANK, ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. WILCOX. Thank you, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I am Noah Wilcox, president and CEO of Grand Rapids State Bank. I am a fourth-generation community banker and a member of the executive committee of the Independent Community Bankers of America. Grand Rapids State Bank is a State-chartered community bank with $230 million in assets located in Grand Rapids, Minnesota. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on credit union member business lending.

ICBA appreciates this opportunity to testify on legislation that would expand credit union powers by raising the cap on member business loans as a percentage of assets. We strongly oppose the Small Business Lending Enhancement Act, S. 509. Congress should not expand credit union business lending powers unless it is also prepared to tax credit unions and require compliance with the Community Reinvestment Act.

The current tax exemption is directly linked to and can only be justified by their original mission of serving individuals of modest means. Credit union business lending is an immediate threat to my bank. I am happy to compete with other taxpaying lenders, even large banks, but the credit union tax exemption creates an unfair advantage and distorts the market.

On countless occasions, I have lost business lending opportunities with established customers to credit unions who underpriced my competitive rates. Just last Friday, as I was preparing for this hearing, a long-time customer, with both personal and business lending relationships, told me they were taking three loans to two separate credit unions. One was a loan on real estate for development that the credit union priced 400 basis points below my competitive rate. The second is a small commercial loan, and the third is a residential mortgage on which the credit union offered a rate in the mid- 3-percent range even though it does not qualify for funding in the secondary market.

S. 509 would allow the NCUA to approve member business loans up to 27.5 percent of a 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 comprise no more than a marginal part of a credit union's lending.

The credit unions have portrayed S. 509 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. We estimate this number to be about half of a percent of the approximately 7,400 credit unions. 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 multimillion-dollar deals, not small business loans. There is ample capacity for the remaining 99.5 percent to expand their member business lending. What is more, there are numerous exceptions to the member business lending cap.

Some advocates of S. 509 claim that the expanded credit union commercial lending would come at no cost to taxpayers.

The Joint Committee on Taxation, the Office of Management and Budget, and the Congressional Budget Office have all identified credit union lending as a tax expenditure. This is why the Bipartisan Policy Center's Debt Reduction Task Force, chaired by former Senator Pete Domenici and former OMB Director Alice Rivlin, recommended eliminating the tax exemption, and it would be appropriate for the Senate to hold hearings on the credit union tax exemption.

What is the cost of the tax subsidy? The most comprehensive and sophisticated analysis to date was done by the nonpartisan Tax Foundation, which valued the subsidy at $3 billion a year and $32 billion over a 10-year budget window. The credit union loan I mentioned earlier that was underpriced by 400 basis points was surely made possible by this tax subsidy and perhaps also a failure to adequately evaluate the risk. The case for repealing the credit union tax exemption stands on its own merits as a deficit reduction measure. When credit unions seek to expand their business lending powers and become the equivalent of banks, linking expanded lending powers to the repeal of the tax exemption is a matter of tax equity.

Thank you again for convening this important hearing, Chairman Johnson. As a community banker, I feel the direct impact of credit union commercial lending, so I am grateful for the opportunity to provide my perspective. ICBA strongly encourages this Committee to reject calls for new powers for tax-subsidized credit unions that will not, despite assertions to the contrary, measurably expand small business credit or create jobs.

I look forward to answering your questions.

Chairman JOHNSON. Thank you, Mr. Wilcox.

Mr. Lussier.

STATEMENT OF MICHAEL LUSSIER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, WEBSTER FIRST FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

Mr. LUSSIER. Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. My name is Mike Lussier, and I am testifying today on behalf of the NAFCU where I currently serve as chairman of the board of directors. I have served as president and CEO of Webster First Federal Credit Union, headquartered in Worcester, Massachusetts, since 1990.

Webster First is a community credit union with over 44,000 members and more than $570 million in assets. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding member business lending and allowing credit unions to further assist in the economic recovery.

When Congress passed the Credit Union Membership Access Act in 1998, it put in place restrictions on the ability of credit unions to offer member business loans, but at the same time asked the Treasury Department to study the need for such a cap.

In January 2001, the Treasury Department released its study and found the following: that credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions. The 1998 Act also established that a business loan of $50,000 and above counts toward the cap. This number was not indexed and has not been adjusted for inflation in nearly 13 years since enactment.

Some critics claim that only a limited percentage of credit unions are actually at the lending cap and, therefore, nothing needs to be done. This view fails to see the big picture of how the cap acts as a disincentive because credit unions that invest in business lending and that are successful will ultimately reach this threshold.

The banking industry argues that the credit union business lending 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 taxes themselves because of their Subchapter S status. There are nearly 2,400 Subchapter S banks that avoid Federal income taxes today, and the value of their tax break is actually greater than the estimated value of the entire credit union tax exemption, as reflected in the Administration's budget.

Webster First has been at the business lending cap for over a year now. At Webster First we understand that member business lending is not about credit unions but about helping small businesses and the jobs they create. It is unfortunate that Webster First cannot handle all the requests to help small businesses that we receive due to this cap.

Webster First has made some great inroads into business lending and has assisted multiple families and businesses in becoming quite successful. For example, we helped an individual purchase an older gas station from his parents. He was able to upgrade all his fuel pumps, computer services, and revamp his store. It now includes a coffee shop, package store, and a multipump service station. His success allowed him to then upgrade the unused property behind the station for storage rental units which quickly became 90 percent utilized. He recently sold the property for a substantial profit and has now acquired other properties to expand his business. And as this Committee knows, business expansion means job creation.

In March, Senator Mark Udall introduced the Small Business Lending Enhancement Act. This bipartisan legislation would raise the credit union member business lending cap to 27.5 percent of total assets, up from 12.25. This would stimulate the Nation's struggling economy by increasing access to credit for small business owners. In order to see its cap increased, a credit union would need to meet strict eligibility requirements before gradually increasing its business loan portfolio. This bill is a well-thought-out solution that includes important provisions to ensure that safety and soundness concerns are addressed. This bill will not only help credit unions but, more importantly, it will help America's small businesses.

NAFCU and its member credit unions ask that the Small Business Lending Enhancement Act be considered by the Banking Committee and on the Senate floor as soon as possible.

In summary, the credit union member business lending cap established in 1998 is arbitrary and outdated. The need for such a cap was questioned by the Treasury Department as far back as 2001. 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 the Small Business Lending Enhancement Act. This legislation would provide a practical and well-thought-out approach to raising the cap while addressing concerns about rapid growth and safety and soundness. NAFCU would also support raising the $50,000 definition of a member business loan as it has not been increased since its inception.

In conclusion, many credit unions have capital to lend small businesses across the country and are in a position to further assist in recovery efforts. However, due to the member business lending cap, they are hampered. Raising this cap will make available immediate funding to help small businesses create much-needed jobs.

I thank you for the time and the opportunity to testify before you today, and I welcome any questions as well. Thank you.

Chairman JOHNSON. Thank you, Mr. Lussier.

Mr. Wilson.

STATEMENT OF STEPHEN P. WILSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LCNB NATIONAL BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. WILSON. Chairman Johnson, Ranking Member Shelby, my name is Steve Wilson. I am chairman and CEO of LCNB Corp. and LCNB National Bank in Lebanon, Ohio. I am also the current chairman of the American Bankers Association.

ABA is strongly opposed to the 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 Senate bill 509, would allow credit unions that are within 80 percent of their member business lending cap to increase this cap and take on significantly more business lending. This would allow a new breed of credit unions to more aggressively pursue business customers through multimillion-dollar commercial loans. It would also serve as an invitation to credit unions that are currently not near this cap to focus on business lending, to the exclusion of consumer lending.

Under current law, credit unions have an aggregate member business lending cap of 12.25 percent of assets. However, business loans under $50,000 do not count against this cap, nor do many other types business loans—leaving ample room for credit unions to serve small businesses. There is a limitation on business lending because credit unions are tax exempt, and this tax exemption is meant to be targeted at people of small means, not real estate developers. Senate bill 509 would allow the NCUA to increase the business lending cap for qualifying credit unions to 27.5 percent of assets—more than double the current cap, and a greater business lending authority than that of Federal thrifts.

A credit union that applies and receives the authority to increase business lending almost certainly would reduce its non- housing-related consumer loans. However, the bill does not require the credit union to notify its 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 an expansion in business lending, an action that would essentially create a tax-exempt bank. In contrast, credit unions that seek mutual savings bank charters must mail such a notice and give such a disclosure and have an affirmative vote.

Make no mistake about it. Senate bill 509 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.

Members of Congress have recognized this fundamental problem repeatedly. Senator Kerry himself stated from the Senate floor, credit unions "were never intended to be simply alternative, tax-exempt commercial banks." There is a strong legislative history that supports the unique charter of credit unions with very specific restrictions on business lending. These restrictions were put in place to protect credit unions from lending that could pose serious threats to their safety and soundness. In addition, they were put in place to ensure that credit unions remained primarily focused on individuals, especially of small means.

The congressional concern 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.

However, there is an alternative. Credit unions that want to expand business opportunities already have an option available to them. They can switch to mutual savings charters. This charter provides the flexibility credit unions desire, preserves the mutual member focus that is the trademark of the credit union charter. Unfortunately, the NCUA has erected obstacles, making it extremely difficult for a credit union to become a mutual savings bank.

I thank you for this opportunity to share ABA's and my thoughts, and I am happy to answer any questions.

Chairman JOHNSON. Thank you, Mr. Wilson.

A question for Mr. Wilson and Mr. Wilcox. Over the past several years, there have been many versions of legislation to remove or raise the cap for member business lending at credit unions. Last year Senator Udall made many changes to his legislation to give more control to the regulator to determine which credit unions should be able to lend above the current cap and to require that such a credit union demonstrate a history of sound underwriting of business loans.

What do you think about the changes made by Senator Udall? And do they address any of your concerns? Mr. Wilson.

Mr. WILSON. Thank you very much. I would like to respond to one thing as I begin here that was in the testimony, and that is that Subchapter S banks do not pay Federal taxes. I am not a Subchapter S bank. I am a $750 million for-profit commercial bank that pays taxes. But I pay taxes twice. I pay taxes as the bank when we make the money, and then I dividend to my owners, the shareholders, and they pay taxes on the same income.

It is true that Subchapter S banks only pay the taxes that is dividended to their owners, but they do pay Federal taxes, and that is quite a misnomer to say that they do not. So I wanted to clear that up.

Now, as to your question, no, there is still a great concern on our part, and the concern is—I will just use my bank as an example. I compete, as a $750 million national bank, against credit unions that are much larger than I am—GE Credit Union, Wright Pat Credit Union. I look at their ads. I look at their billboards. And the first thing they say is if you work, live, worship, in essence breathe in my market area, you are their member. So, first of all, this whole idea that they have a common bond is not true. So they are competing directly with me.

I am awash in liquidity. My normal loan-to-deposit ratio is between 75 and 80 percent, and that is pretty conservative for a bank. I am down to 60 to 65 percent. I want to make loans, and I want to make loans bad. I fall all over any small business person that comes in my office and wants to have a loan because I need those loans.

Now, there are only two reasons I am going to lose a loan to a credit union. Number one, they are going to use their tax-exempt status to underprice me. You must realize that when I make a dollar, I only keep 60, 70 percent of that dollar. When they make a dollar, they keep 100 percent of it. So they have quite an ability and advertise that ability that they can pay more on deposits and charge less for loans. So they use that tax-exempt status. They do not have the common bond. And so I can lose a loan because they can underprice me, or I can lose a commercial loan because I would not have made it in the first place, and they are willing to make a loan or take more risk than I am willing to take. And I do not know that that is in the best interest of the credit union charter.

You know, I like the credit union charter. ABA is for charter choice. It is the foundation, the absolute foundation of the dual banking system. But different charters have different restrictions, and these business lending caps should stay in place.

Chairman JOHNSON. Mr. Wilcox.

Mr. WILCOX. The changes that you inquired about simply do not go far enough, first of all, but I, like Mr. Wilson, compete directly with credit unions in my market that are in some cases four or five times the size of my $230 million bank. They do use their tax-exempt status to very selectively target the loans that they would like to take and in a fashion that I simply cannot compete with on price. In many cases we do see increased risk in loans that are not able to be underwritten in a safe and sound manner taken on in some cases in the credit unions, and the restrictions that are in place are there for a reason. If they would like to enjoy their tax-exempt status and continue to do so, those restrictions should remain in place.

But, you know, I would be the first to say I would welcome all credit unions to make the Subchapter S election to pass those taxes on to their members, just like I pass on—I am a Subchapter S community bank, and our shareholders do pay the tax. We do not pay tax at the corporate level, but our shareholders pay that State and Federal tax, in our case at quite a high rate. So I would encourage all credit unions to make that election and go ahead and support that tax, and if they want to do that, then engage in commercial lending as they see fit.

Chairman JOHNSON. Thank you, Mr. Wilcox.

Mr. Cheney and Mr. Lussier, it appears that the levels of delinquent member business loans and charge-offs have increased. Does the current economic climate dissuade you from underwriting member business loans? Mr. Cheney.

Mr. CHENEY. Thank you. It is true that member business lending delinquency increased, as did charge-offs, during the economic crisis. But recently we have seen those numbers come down, and interestingly, as is reflected in our written testimony, credit union member business loans actually performed much better than bank loans.

I will say that underwriting standards are credit unions, as I am sure at all financial institutions, have gotten another look from a management perspective because of the crisis. But the credit unions have a strong track record of safe and sound business lending.

Chairman JOHNSON. Mr. Lussier.

Mr. LUSSIER. Yes, sir, thank you. First of all, I think that when you look at the delinquencies on the business loans, we have to take into consideration that the real estate loans, consumer loan portfolio, credit card portfolios delinquencies have all been increased with the downturn in the economy. One of the things I will say is that the delinquent loans that we have had in our portfolio—I can only speak for Webster right now, but our delinquencies in the commercial loan portfolio are 2 percent. Our losses are nearly nil. I believe there has been one substantial loan that we had taken a loss on, which represented about $100,000 in loss, of which we basically regained some of that loss when the property was resold.

So speaking on behalf of an institution that writes well-underwritten and secured loans in the business loan portfolio, I find that the delinquencies are rare. I think we are OK. We are able to continue writing loans. We are maxed out, like I stated in the beginning, and we are at the cap. And we continue to look for the opportunity to serve the business people in our community regardless of the present delinquency status.

Chairman JOHNSON. Mr. Lussier, how do you manage the risks associated with business loans at your institution during these difficult economic times?

Mr. LUSSIER. Well, first and foremost, a couple comments were made about the big multimillion-dollar loans. We have a couple loans that are sizable. I think the largest one is probably $3 million. However, a majority of our loans are diversified among small business owners who are pretty much looking for the $50,000 to the $250,000 loan. I would say that 80 percent to 85 percent of my loan portfolio fits within a national average of approximately $233,000 on average. We basically diversify among collateralization for real estate, equipment, heavy equipment, very few on receivables. We are pretty much conservative on who we underwrite to, but we actually look at all the businesses that come in and request our lending. We give them all an opportunity today, and we try to make sure that if it possible that we can lend them the money to enhance their businesses we do so in the best fashion possible. But we also make sure that we are not giving away money.

So we follow the rules and regulations that are set forth by NCUA, and they also come in to make sure that we are diversified and that we do not have a high concentration in any area. That is how we reduce our risk.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Lussier, in Mr. Wilson's testimony he argues that increasing the business lending cap would allow credit unions to look and act just like banks, as you heard, without having to pay taxes or comply with bank-like regulatory requirements. How do you respond to those concerns that the playing field is not level because credit unions are tax exempt and so forth?

Mr. LUSSIER. Well, we could talk about this all day, but I will say——

Senator SHELBY. I think that is an important subject.

Mr. LUSSIER. Yes, and I agree with you. Thank you for asking me. I will say this: There are major differences between a credit union and a bank, and without going through the whole platter of the differences, I will say that a majority of the difference is that we run on volunteerism. Our institutions are run under more regulatory restraints than the banks can be—than the banks are. This——

Senator SHELBY. Say that again. Are you saying that the credit unions are under more regulatory scrutiny than the banks?

Mr. LUSSIER. We are under more regulatory restraints than the banks, and here is an example. We are trying to basically increase our limitations on business lending. We have more restrictions on what we can offer because we are credit unions. And all we are asking here is that we need to be able to increase these limitations slightly in order to better enhance our services to the members.

Senator SHELBY. CAMELS ratings are an important indication of the safety and soundness of any financial institution, credit union. Would you support requiring a credit union to have a CAMELS rating of 1 or 2 before its business lending cap could be increased? Because that goes to safety and soundness.

Mr. LUSSIER. Well, there is no doubt. A 1 and 2, it definitely shows you that an institution is safe and sound. A CAMEL rating 3 does not mean an institution is failing and is not safe and sound. A CAMEL 3——

Senator SHELBY. It does not mean it is failing, but it is an indication it might not be strong.

Mr. LUSSIER. I would agree with you.

Senator SHELBY. OK.

Mr. LUSSIER. I would agree with you. But a CAMEL rating 1 and 2 institution moving ahead to have the possibility of increasing according to these limitations, I would support 100 percent.

Senator SHELBY. Mr. Cheney, you argue, as I understand it, that the cap on business lending disproportionately hurts small credit unions.

Mr. CHENEY. Yes.

Senator SHELBY. You have also indicated that raising the cap to 27.5 percent would—these are your words—change the economics significantly, making it possible for credit unions as small as $20 million to reasonably participate in this market. Those are your words. What is the basis for determining that increasing the cap to 27.5 will be sufficient for small credit unions to participate in business lending?

Mr. CHENEY. Well, thank you, Senator. The basis for it is that it allows more credit unions to be able to justify the investment necessary to set up a business lending operation. You have to hire people that have experience in the field. You have to set up procedures and systems and safeguards and internal controls, so that is really the basis for that statement.

Senator SHELBY. You also in your testimony, Mr. Cheney, point out that nearly 70 percent of credit unions do not engage in any business lending currently. Why do so few credit unions currently make business loans? And for those credit unions that do business lending, what are the most common types of loans that they make?

Mr. CHENEY. We think that the cap is a reason that so few credit unions do business lending because the restriction is so low. And, by the way, before 1998, there was no restriction on credit union business lending. There was no cap. But the cap, if you are a $20 million or a $50 million credit union, you cannot justify the expense. So we think raising the cap, as Chairman Matz said, will encourage more credit unions to get involved. And in terms of the types of lending, the average credit union member business loan is less than $250,000. Most are small business loans—not all, but most credit unions make loans to small businesses, as Mr. Lussier said is the case with his credit union.

Senator SHELBY. Mr. Wilson, you probably were here earlier when Chairman Matz testified. She noted that one way to deal with the credit crunch would be to increase the business lending cap. She noted also that access to credit remains difficult for many small businesses and entrepreneurs that depend on financial institutions for funding.

Why do you think that many small businesses are facing a credit crunch?

Mr. WILSON. Because of the state of the economy. Their cashflows are down. Their collateral has been diminished. There are a number of reasons. There are people that we would have lent to in the past that we cannot lend to today, and hopefully we will be able to lend to tomorrow. And I think it wise that we do not from a safety and soundness standpoint.

You know, one of the statements that was made that kind of mystified me was that credit unions are more tightly regulated than banks, and particularly in the commercial lending——

Senator SHELBY. It intrigued some of us, too.

Mr. WILSON. That was an interesting statement. You know, they made the statement in testimony that, boy, they do a better job because they have had less charge-offs than we have had as banks. And so I was curious about that, and I went to the CUNA site and gathered some statistics, and it seems like we are not comparing apples to apples here, because I would say that my regulator, the Office of the Comptroller of the Currency, is much stricter. I was amazed at the reason that they avoid charge-offs, and that is because they allow delinquencies 12 months and beyond. They have a great bucket of loans that are delinquent more than 12 months.

Senator SHELBY. What would you——

Mr. WILSON. Banking regulators would have had us write those off well before they get to 12 months, so that is not really a fair comparison.

The other thing that is such a misnomer, that even though tax exempt and having the requirement to serve people of modest means, you probably are aware that GAO did a study on that and, in fact, banks service more low- to moderate-income individuals, households, than credit unions do. The GAO found that a low- to moderate-income service in banks was 41 percent of the households. In credit unions it was 31 percent of the households. Let us get rid of this tax exemption. Let us compete head on and let us take care of small businesses and let us create jobs.

Senator SHELBY. Mr. Wilson, has the Dodd-Frank legislation and other regulatory burdens had an impact on the ability of banks to make loans to small businesses?

Mr. WILSON. Oh, absolutely. Absolutely. The time we spend on regulatory burden, the uncertainty that all of this regulatory environment and the tax environment has created has caused many of our good business customers, those that would normally be expanding, buying plant and equipment, creating jobs, not to pull the trigger on projects. I do not think I have ever had a larger pipeline of loans where the individual businesses are not willing to pull the trigger because of the uncertainty of taxes and regulation, *et cetera.*

Senator SHELBY. Mr. Wilson, I think you went into this a little bit earlier, but I want to, for the record, go back into it. Both Mr. Cheney and Mr. Lussier note in their testimony that about one-third of all banks or Subchapter S corporations are exempt from Federal income tax. They argue that puts many banks on a more equal playing field with credit unions. You talked about that earlier. Just again for the record, how does the tax treatment of Subchapter S corporations compare to the taxation of credit unions? I thought tax—am I wrong? Credit unions are exempt from tax, period.

Mr. WILSON. Period. That is correct.

Senator SHELBY. Whereas, if you are a Subchapter S corporation, it passes to the owners and they pay the tax.

Mr. WILSON. That is correct.

Senator SHELBY. So the tax is paid one or both ways. Is that right?

Mr. WILSON. That is correct. It is paid—if you are a C corporation, you pay it twice. You pay it when you make it, and your owners pay it when they receive it in the form of dividends. In the case of Subchapter S, they only pay it once, but they pay it. They are taxpaying entities, and I do not have a problem whatsoever as a C corporation competing against a Subchapter S.

Senator SHELBY. Mr. Wilcox, in your testimony you also noted that your bank has lost business lending opportunities with established customers to credit unions. You argue that the credit union tax exemption creates an unfair advantage and distorts the market. Just again for the record here, how does the credit union tax exemption undermine your ability to offer competitive rates? Is it because you are taxed and they are not?

Mr. WILCOX. That is correct.

Senator SHELBY. OK. Also, Mr. Wilcox, Mr. Cheney states in his testimony that business loan net charge-off rates for credit unions have been roughly one-fourth of the average for banks since 1998. Accordingly, he argues that credit unions can provide business lending in a more safe and sound manner than banks. Why do credit unions appear to have lower net charge-off rates for business lending than banks? Is there a reason here? Is it the way they are regulated? Is it the way they approach it? Or what is it?

Mr. WILCOX. Well, it could have to do with some of that, and I think Mr. Wilson spoke to a few of those facts. Banks are under very strict regulatory requirements, especially as it pertains to charge-offs. We have hard caps on days delinquent, and then depending on the type of credit that it is, it is demanded to be charged off. If not, you do face some pretty severe regulatory scrutiny. All of the Federal regulators as well as the State regulators—in my case I see both as a State chartered bank—do look at that on a very regular basis, each examination. They are looking from a safety and soundness perspective to be certain that the banks are not only managing their delinquency but not hiding it. It would be inconceivable for me to have a loan that is severely delinquent and be able to carry it continuously on my books for 12 months and not charged off. I would be criticized and could possibly face enforcement orders or other things of that nature if that was as routine practice in a bank.

Senator SHELBY. Would that be what we call "toxic assets"?

Mr. WILCOX. I would not want them on my books.

Senator SHELBY. Thank you.

Mr. CHENEY. Senator, might I comment on that as well? I am sorry. In terms of charge-offs versus delinquencies, credit unions' charge-offs are lower than banks' but credit unions' delinquency is lower than banks' too. I do not think it is a situation where credit unions are hiding delinquency by putting it in charge-offs because it has got to be in there somewhere. It is one or the other.

In terms of loans that are delinquent that have been on the books for a long period of time, those are easily discernible, as Mr. Wilson did, from credit union call reports and is something that the regulators track very closely. If there is a loan that is on there for more than 12 months, I can assure you there is a reason for that.

And if I might also, just while I have the microphone, comment on Subchapter S status. When credit unions distribute their earnings to their members in the form of dividends, their members, who are the owners of the credit union, pay taxes on those dividends. A tax on a credit union is nothing more than a tax on a credit union member.

Mr. WILCOX. If I might, Senator?

Senator SHELBY. Yes.

Mr. WILCOX. That does presume that the credit union is paying the dividends to the members. I am a Subchapter S bank. I was a C corporation before we were allowed to take that election. With the election come many restrictions, and we chose to operate within those confines. However, whether or not the Subchapter S makes a dividend distribution to its shareholders, the tax must be paid, period. So even if the holding company or the bank does not make that distribution——

Senator SHELBY. Tax on earnings, would it not?

Mr. WILCOX. That is correct. Whether or not the shareholders receive a dividend check from a Subchapter S bank, the shareholders pay the tax every quarter.

Senator SHELBY. If there are some earnings.

Mr. WILCOX. Right.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman JOHNSON. I want to thank the witnesses for this testimony on this issue. As we have seen, the views on these issues are varied, and I think today's hearing yielded some good information for us to review as we consider this issue going forward.

Thanks again to my colleagues and our panelists for being here today. This hearing is adjourned.

[Whereupon, at 11:26 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN TIM JOHNSON

I want to welcome and thank our witnesses for being here today to testify on the issue of credit union member business lending.

Under the Federal Credit Union Act, credit unions are limited in the amount of business lending they are permitted to engage in. 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 percent of the credit union's total assets. The member business lending cap was put in place in 1998 with the passage by Congress of the Credit Union Membership Access Act.

Since that time, the credit union industry has advocated for a removal of, or increase in, the business lending cap. Senator Mark Udall has introduced legislation that would raise the cap to 27.5 percent of total assets.

There is a wide range of views on this matter, especially as Congress considers proposals to speed the economic recovery.

I think that it is important that we take the time to examine this issue here in Committee, and provide the opportunity for all sides to fully express their views on the subject.

PREPARED STATEMENT OF SENATOR RICHARD C. SHELBY

Thank you, Mr. Chairman, historically, credit unions have focused on meeting the savings and credit needs of their members, especially people of modest means. In recognition of this unique role, credit unions, unlike banks, have been tax-exempt.

Today, the Committee will examine whether credit unions should be allowed to lend to businesses. This is not the first time the issue of business lending by credit unions has come before this Committee.

In 1998, this Committee passed, and Congress eventually enacted, legislation that placed significant restrictions on business lending by federally insured credit unions.

At that time, the number of business loans made by credit unions was quite small. In fact, a report of this Committee that accompanied that legislation acknowledged that consumer loans made up nearly 99 percent of all credit union lending.

Nevertheless, Congress limited business lending in order to prevent excessive risk-taking by credit unions.

A report by the National Credit Union Administration had found that business lending caused half of the losses to the National Credit Union Share Insurance Fund in the 2 prior years.

Additionally, in 1991 another report found that failing credit unions had made more business loans than other credit unions.

Now, the ongoing credit crisis has prompted some to propose increasing the business lending limit.

The credit crunch is a problem of concern to us all.

As we examine this issue, however, we should first ask why credit is so hard to obtain.

In particular, how has the Dodd-Frank Act affected credit availability?

Alternatively, is the unprecedented Federal deficit crowding out private sector lending?

If we want to address the problem of credit availability to small businesses, a more comprehensive approach may be appropriate.

In addition, we should ask how changing business lending limits would affect the safety and soundness of credit unions.

Even with the current limitations on business lending, we continue to see credit union failures.

Recently, the NCUA announced the 13th closure or conservatorship of a credit union this year. Over the last 2 years, 55 credit unions have failed.

I hope to learn today whether business lending was a contributing factor in any of these failures.

Changing the business lending limitations can alter the competitive landscape not only between banks and credit unions, but also among credit unions.

Although they are not here today, we will need to hear from the bank regulators so that we can fully understand the effect such a change would have on the entire industry.

Ultimately, healthy and strong credit unions are good for our economy and consumers. It is my hope that today's hearing will shed more light on how we can ensure that credit unions continue to serve their unique and important role in the Nation's economy.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR CHARLES E. SCHUMER

Thank you Mr. Chairman. I want to thank you for holding this important hearing, on an issue I have cared deeply about for some time now: lifting the artificial restraints we currently place on the ability of credit unions to help small businesses access much-needed credit.

As we heard in testimony from Chairman Matz and Mr. Cheney today, credit unions have been engaged in member business lending since their creation. And only since 1998 have they been subject to this arbitrary cap on their business lending, which effectively limits each credit union's business lending to no more than 12.25 percent of their total assets.

In the past two Congresses I have introduced bills that would raise or eliminate this cap. Last Congress, my good friend from Colorado, Senator Mark Udall, took up the cause with a bill to raise the cap to 27.5 percent of total assets as long as certain criteria to ensure safety and soundness are met. He has reintroduced his bill this Congress, with bipartisan support and a total of 19 cosponsors, including Senators Reed and Brown on the Banking Committee.

I want to say a few words about the bill and encourage all of my colleagues to support this commonsense way to immediately increase the amount of credit available to small businesses—at no cost to the taxpayer.

We just came through the worst credit crunch any of us have ever seen, and access to credit is still a significant issue for small businesses in NY and all over the country. Even through the downturn, credit unions have continued to increase their business lending, but they are limited in their ability to do more. Senator Udall's bill will provide a much-needed boost to help small businesses expand and hire.

In the Fall, Congress passed, and the President signed into law, a bill to help small businesses that included a $30 billion fund to help community banks increase their lending to small businesses. I strongly supported the creation of that Small Business Lending Fund, but Senator Udall and I and others fought to include his legislation for credit unions in that bill. We ultimately did not prevail. Well, nearly 9 months later that $30 billion fund has barely been put to work.

I hold out hope that the Fund will be put to good use easing the burden on small businesses, but credit unions are waiting to fill the gap, and I don't see why we should unnecessarily limit ourselves—credit unions are an important source of credit for individuals and small businesses in this country, and it's important that we ask what they can do to help get our economy grow again.

When the idea for the Member Business Lending bill was originally proposed, some concerns were raised about safety and soundness of the credit unions themselves, their members, and the credit unions' insurance fund. So my office worked with Senator Udall's staff and the Treasury and NCUA to come up with a plan that would address those concerns.

- First, the cap is only raised for credit unions that meet strict eligibility criteria. To qualify, credit unions must be well capitalized, demonstrate sound underwriting and servicing based on historical performance, have strong management and policies to manage increased lending, and be approved by their regulator for the higher cap.
- They must also be at or above 80 percent of their current cap, with 5 or more years of experience lending to member businesses. This means that only credit unions with significant experience lending to small businesses will have their cap raised, and it is targeted at those credit unions most likely to expand their lending because they are at or near the existing cap.
- Even if they meet the criteria, credit unions can't grow their lending by more than 30 percent in any 1 year, and their regulator can make them grow even slower. That will ensure that credit unions don't grow their business faster than they can handle.

Based on conservative estimates, this amendment could lead directly to over $12 billion in new lending and create up to 140,000 new jobs. In my home State of New York, it could create over $1 billion in new lending and up to 9,000 new jobs. And it does all that at NO COST to the Federal Government.

Certainly this is not a cure-all for our economy. But with small businesses still struggling to get the credit the need, it seems to me that we should be trying everything we can to increase lending. And this amendment does it in a sensible way, to ensure safety and soundness are preserved in the system, and, I repeat, without costing any taxpayer money.

In short, this just makes sense and I urge my colleagues to support the legislation sponsored by my friend from Colorado.

PREPARED STATEMENT OF DEBORAH MATZ

CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

JUNE 16, 2011

Embargoed Until Delivery
10:00 a.m. EDT
June 16, 2011

STATEMENT

OF

THE HONORABLE DEBBIE MATZ
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"CREDIT UNIONS: MEMBER BUSINESS LENDING"

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

THURSDAY, JUNE 16, 2011

I. Introduction

The National Credit Union Administration (NCUA) appreciates the opportunity to provide views on credit unions and member business lending. 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 Committee has asked NCUA to comment on the agency's experience with member business loans (MBLs), the agency's views on legislative proposals to increase the MBL limit, and any recommendations NCUA has to ensure safe and sound member business lending.

This written testimony will provide a general background and history of credit union member business lending, including the reasons why statutory MBL 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 MBL trends as credit unions continue to rebound from the largest financial crisis since the Great Depression. And 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 7,292 federally insured credit unions, representing 98 percent of all credit unions and 90.8 million members.[2]

III. Importance of Small Businesses Having Access to Credit

Many businesses, especially small businesses, count on credit to finance their operations, such as inventories, and to meet weekly payrolls. Disruptions in the availability of credit have been associated with particularly painful downturns. Our most recent contraction, dubbed by some as the "Great Recession," is no exception. 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. Credit contracted sharply. Bank loans to non-farm, non-corporate businesses (outside of mortgages) fell almost 20 percent from the end of 2008 to the end of 2009.

[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 Fund was established as a revolving fund in the United States Treasury under 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.
[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.

The economic consequences of the credit contraction that began in the fall of 2008 were immediate and severe. Businesses liquidated inventories, consumer demand disappeared, and worker layoffs surged. From December 2007 to the low point in February 2010, the economy lost 8.7 million jobs, and despite recent improvements, overall, U.S. payrolls have lost 6.9 million jobs from December 2007.

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 early stages of the recovery (July 2009 through November 2010), employment at firms with fewer than 50 employees declined roughly another 3 percent, while employment at larger firms rose.

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 the FDIC Statistics on Depository Institutions, net loans and leases by all FDIC-insured institutions fell by nearly 9 percent between year-end 2008 and the first quarter of 2011, including a decline of 1.6 percent so far in 2011. Starting in the first quarter of 2010, information became available on "small business" loans (defined as loans less than $1 million) in several categories. Between the first quarter of 2010 and the first quarter of 2011, total small business loans secured by non-farm, non-residential properties fell by 7 percent, and loans less than $100,000 fell by 14 percent. Small business commercial and industrial loans fell by 10.3 percent over the same period.

Clearly, the contraction in credit represents declines in both demand and supply, particularly in commercial real estate and construction and land development. Nevertheless, research indicates access to credit is a concern for small business owners. A recent survey shows that the net percent of respondents indicating that credit was harder to get more than tripled (from 5 percent to 16 percent) to the highest share on record between early 2007 and early 2009 (May 2009).[3] While the situation has improved, concerns about difficulty accessing credit remain elevated.

Credit Unions' Small But Important Role in Business Lending

Though making up only approximately 1 percent of total commercial loans in the United States,[4] credit unions serve an important role in lending to small businesses and continued to extend credit during the economic downturn. Today credit unions have more than 167,000 outstanding loans to businesses.

[3] National Federation of Independent Businesses' *Small Business Economic Trends*, May 2011.

[4] Mortgage Bankers Association Commercial and Multifamily Mortgage Debt Outstanding Report as of June 30, 2010. <http://www.mortgagebankers.org/NewsandMedia/PressCenter/74019.htm>

Small businesses rely on financing far more than larger businesses. Smaller financial institutions play a critical role in providing credit to small businesses.[5] Credit unions are well suited to prudently offer credit to small businesses, which in turn will help create jobs and spur economic growth.

Credit unions serve an important niche, typically making the smallest of the small business loans. The dollar-weighted average credit union MBL is $223,000,[6] indicating credit unions are predominantly serving the needs of small businesses. The two most common types of loans—non-farm residential property loans and commercial and industrial loans—average $160,000 and $127,000, respectively.[7]

Credit unions continued to serve as a source of credit for consumers and small businesses during the economic downturn and recovery. Over the period from year-end 2007 through the first quarter of 2011, credit union lending increased by nearly 6 percent. Total member business loans, in particular, increased by 41.4 percent during this timeframe. Member business loans with portions guaranteed by the Small Business Administration (SBA) grew by 81 percent.

[5] Commercial banks with less than $10 billion in assets account for only 19 percent of assets, but 45 percent of small business commercial & industrial lending (using the FDIC definition). All but three credit unions have less than $10 billion in assets.
[6] The median of the average member business loan size by credit union lender is only $127,000.
[7] The average loan size of all commercial and industrial loans made by commercial banks is $643,000. Federal Reserve's *Survey of Terms of Business Lending* (Feb 2011).

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 inception of our nation's credit union movement in 1908. From their roots, credit unions have played a small, yet crucial role in supplying credit to farmers, immigrants and small business owners. In fact, the first credit union ever chartered in the United States, St. Mary's Bank Credit Union, had as a 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.

Credit Unions Have a Successful Business Lending History

Many credit unions have successfully provided credit to meet the business needs of their members for decades. Congress recognized this fact in 1998 when enacting the Credit Union Membership Access Act (CUMAA) [Public Law 105-219]. CUMAA provided an exception to the business lending cap imposed on credit unions for those institutions 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. 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%." 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."[8]

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 the lack of necessary expertise combined with the challenging macroeconomic conditions at the time, over a two-year period in the late 1980s, nearly half of the losses sustained by the NCUSIF directly or indirectly resulted from losses in business lending portfolios.

During this time period and since, NCUA increased supervisory oversight of credit unions involved in business lending, especially those in challenging markets. NCUA also began collecting more specific MBL data on credit union Call Reports.

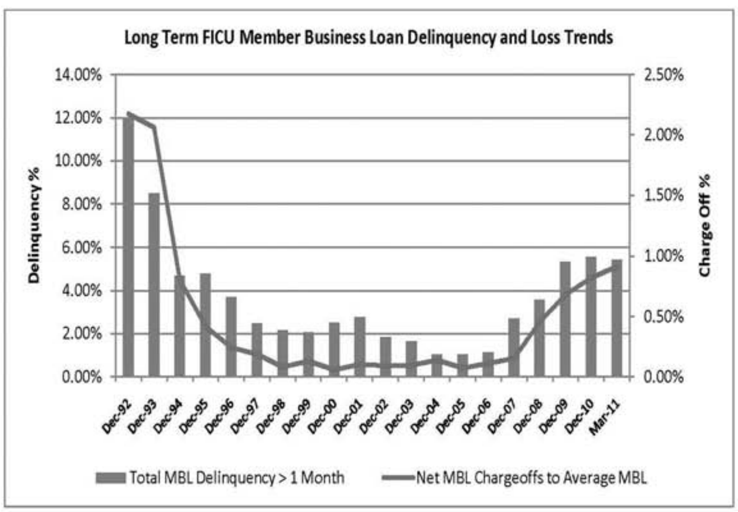
In 1987 the agency adopted its first Rule and Regulation specifically devoted to member business lending. This regulation (what is now encompassed by Part 723 of NCUA's Rules and Regulations) provided a more robust prudential regulatory framework to

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

better manage the risks business lending activity posed to credit unions and the Share Insurance Fund.[9]

NCUA has periodically made various enhancements to the MBL rule since adoption in 1987. 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. 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 (see Figure 1 below).

Figure 1



[9] NCUA's MBL 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.

Member Business Lending Statutory Cap

In 1998, CUMAA codified in the Federal Credit Union Act the definition of an MBL[10] and established a statutory aggregate limit on outstanding MBLs 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. Certain loans, including loans less than $50,000 or portions of loans guaranteed by a governmental agency, are not counted for the purpose of the aggregate loan limit.

The statute exempts from the aggregate MBL 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;[11]

(2) credit unions chartered for the purpose of making member business loans; and

(3) credit unions that had a history of primarily making member business loans when the statute was enacted.[12]

[10] The Federal Credit Union Act's definition of a member business loan is incorporated in Part 723 of the NCUA Rules and Regulations. A member business loan 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. [12 CFR 723.1(b) and (c)]

[11] There are 1,116 credit unions that are low-income designated and/or participate in the CDFI. The median asset size for these credit unions is $8.5 million. Twenty-five percent of these credit unions grant MBLs.

[12] 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 over 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. Thus a total of 1,177 credit unions are not subject to the cap.

Collectively, 1,177 credit unions qualify for these exemptions. Thus, the other 6,115 credit unions—about 85 percent of all credit unions, representing 94 percent of assets and 75 percent of current member business lending—are subject to the statutory cap.

Effective member business lending requires the creation of internal policies and procedures to engage safely and soundly in this activity. It also requires the hiring of professionals with sufficient knowledge of business lending to judge the quality of the loan applications and to monitor the performance of the loans once made—especially cash flow, portfolio management, and liability issues.

The low statutory cap also 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 program cost-effective. As a result, some credit unions that would otherwise elect to meet their member business financing needs do not offer member business loans.

Figure 2 shows the share 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 70 percent of credit unions subject to the cap do not offer MBLs, and nearly one-quarter of credit unions subject to the cap with more than $100 million in assets do not offer MBLs. As of March 2011, 289 credit unions (including those with grandfathered regulatory waivers) are at or near the current statutory MBL cap.

Figure 2

Member Business Lending Compared to Current Statutory Limit: First 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%+
				(% of CUs)			
<$10M	2,106	8.59	0.01	97.63	2.14	0.14	0.09
$10M to $50M	2,057	49.97	0.39	76.52	20.42	1.70	1.36
$50M to $100M	700	49.24	0.67	54.00	39.14	3.86	3.00
$100M to $500M	891	196.99	5.60	29.18	53.20	10.55	7.07
$500M to $1B	195	136.59	6.25	11.28	56.41	17.95	14.36
$1B+	166	437.37	15.09	9.64	56.63	21.69	12.05
Total	6,115	878.75	28.02	70.42	23.17	3.76	2.65

Notes: Excludes the 1,177 credit unions that are not subject to the statutory cap based on either low-income credit union status or a charter exclusion. There are 1,116 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 statutory limit, thus limiting the avenues of credit available to small businesses.

Legislation proposed by Senator Mark Udall (S. 509) would allow well capitalized and well managed credit unions with a proven track record of member business lending to grow their MBL portfolios—in small, manageable increments—to as much 27.5 percent of total assets.[13]

This statutory change would allow credit unions with well managed MBL programs to provide additional funding to meet the financial needs of their members and their communities, thereby contributing to the economic recovery and job growth. Further, the provisions of S. 509 requiring a tiered implementation of a higher cap are appropriate safeguards to ensure this authority is exercised only after credit unions offering MBLs have demonstrated proper controls.[14]

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. NCUA projects that credit unions could extend several billion more dollars in member business loans in the first few years after passage and implementation of S. 509. If each credit union most likely to qualify immediately for higher MBL limits under the bill increased

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[13] Under S. 509, 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.

[14] For credit unions meeting certain criteria, S. 509 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 MBL 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.

member business lending by 30 percent, more than $2 billion in credit would be extended.

In addition, some credit unions that are not presently near the cap, including some that do not make MBLs, are likely to increase their MBL activity because they could achieve appropriate economies over the long term with the higher cap.

How quickly and to what degree credit unions would respond remains uncertain. Using conservative assumptions, over the next few years, it is possible that an additional $2 billion to $3 billion in credit could be made available through these channels.

However, the current cap limits credit unions' abilities to diversify their loan portfolios. At this time, the portfolios of many credit unions are invested heavily in long-term, fixed-rate mortgages. Such assets have greater exposure to interest-rate risk. 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 could allow credit unions to diversify the risk of their loan portfolio, with member business lending typically involving less interest-rate risk than long-term, fixed-rate mortgages.

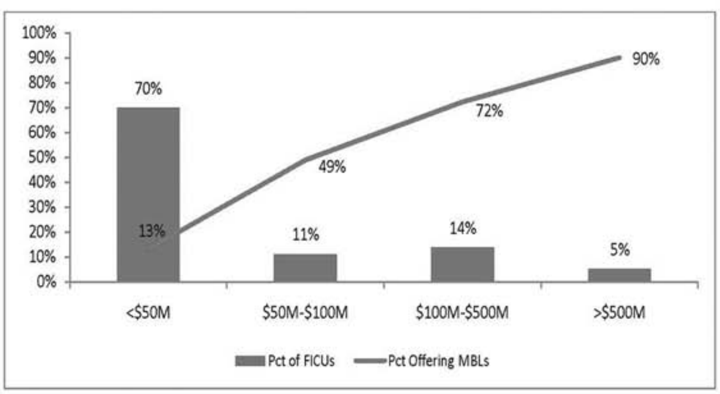
V. Member Business Lending in Credit Unions Today

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 March 31, 2011, 30 percent (2,148) of credit unions provide credit to businesses.[15] Figure 3 shows the size distribution of credit unions engaged in member business lending compared to the population of all federally insured credit unions. In brief, this chart shows that the smaller a credit union's size, the less likely it is to engage in member business lending.

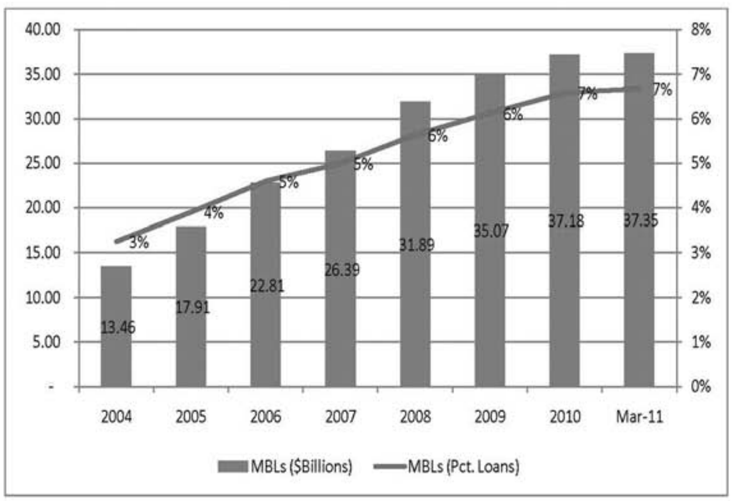
Figure 3



[15] Unless otherwise indicated, all data provided is as of March 31, 2011.

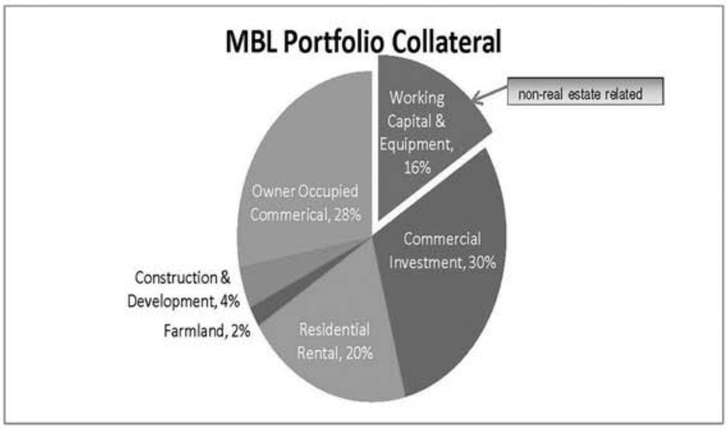
In 2010, credit unions originated or purchased $12.1 billion in MBLs. Another $3.1 billion were added in the first quarter of 2011. Outstanding balances of MBLs as of March 31, 2011, total $35.7 billion (without unfunded commitments) and comprise 6.4 percent of total loans and 4 percent of total credit union industry assets. (Figure 4 includes unfunded commitments).

Figure 4



The majority of MBLs, $31.4 billion or 84 percent, are secured by real estate. Agricultural-related MBLs have steadily grown to $1.4 billion, representing approximately 4 percent of total MBLs (see Figure 5 below). Construction and development MBLs declined in both 2009 and 2010; however, an increase of $146.6 million, or 10.3 percent, to $1.6 billion was noted in March 2011.

Figure 5



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 $7.5 billion), followed by New York credit unions (11 percent or $4.2 billion), then Wisconsin credit unions (6 percent or $2.3 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 $497 million in agricultural MBLs, representing 74 percent of the state's total MBLs, with a portfolio delinquency rate of 0.53 percent—very low compared to credit unions nationwide.

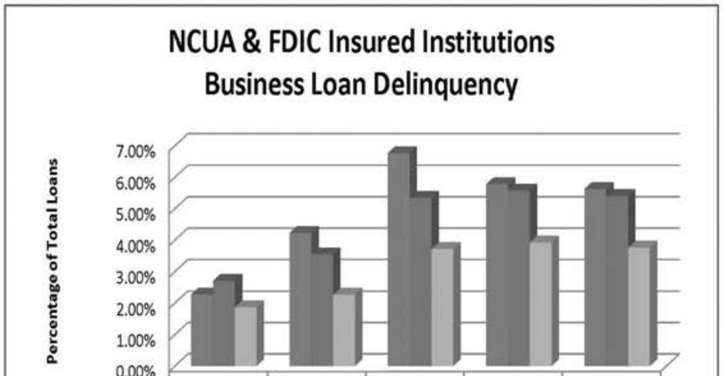
Recent Stresses on MBL Performance

Like other types of loans, MBLs perform in a cyclical manner. Understandably, the MBL portion of credit unions' loan portfolios has suffered from the adverse effects of the protracted economic downturn. The level of delinquent member business loans has increased from 0.53 percent at year-end 2006, to a high of 3.93 percent as of December 2010, moderating somewhat to 3.76 percent as of March 2011. The average MBL delinquency ratio by credit union, however, is 2.60 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 "sand states" account for 40 percent of all delinquent MBLs, but only represent 15 percent of credit unions offering MBLs.[16] Losses on MBLs increased from 0.11 percent in 2006 to 0.91 percent (last 12 months as of March 2011). The credit unions located in the sand states account for 49 percent of losses on MBLs. As Figure 6 illustrates, despite the recent increase during the economic downturn, current credit union MBL delinquency levels remain lower than other federally insured financial institutions.

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

Figure 6



	2007	2008	2009	2010	2011
FDIC >30 days	2.28%	4.23%	6.77%	5.78%	5.63%
NCUA >30 days	2.71%	3.55%	5.34%	5.57%	5.41%
NCUA >60 days	1.87%	2.27%	3.72%	3.93%	3.76%

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 (46) 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 MBL programs, and inadequate third-party vendor due diligence played an integral part in the failure of these nine credit unions.[17]

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 be conducted in a safe, sound and prudent manner with appropriate regulatory safeguards. 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.

VI. Conclusion

NCUA recognizes the importance of small businesses in our nation's economy. S. 509 has the potential to increase the access of small businesses to capital and to promote job growth. As such, NCUA supports efforts to allow credit unions to provide

[17] 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 this authority.

businesses additional avenues of credit when appropriate under a comprehensive regulatory framework, by increasing or eliminating the current statutory MBL limitation.

NCUA further believes that 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 lending limit for credit unions, 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 90.8 million consumers who place their trust in federally insured credit unions.

PREPARED STATEMENT OF BILL CHENEY

PRESIDENT AND CHIEF EXECUTIVE OFFICER, CREDIT UNION NATIONAL ASSOCIATION

JUNE 16, 2011

CUNA & Affiliates

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TESTIMONY OF
BILL CHENEY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

HEARING ON
"CREDIT UNIONS: MEMBER BUSINESS LENDING"

JUNE 16, 2011

A member of the Credit Union System℠

Testimony of
Bill Cheney
President and Chief Executive Officer
Credit Union National Association
Before the
United States Senate
Committee on Banking, Housing and Urban Affairs
Hearing on
"Credit Unions: Member Business Lending"
June 16, 2011

Mr. Chairman, Ranking Member Shelby, Members of the Committee, thank you very much for calling today's hearing on credit union member business lending and giving me the opportunity to testify on behalf of the Credit Union National Association (CUNA)[1]. My name is Bill Cheney and I am CUNA's President and Chief Executive Officer.

Although credit unions generally weathered the crisis well, remaining well capitalized and continuing to lend while other lenders pulled back access to credit, the economy as a whole is struggling to recover from the most significant financial crisis since the Great Depression. Congress and the Administration have taken several steps to address these problems. Unfortunately, unemployment remains very high. Small businesses, many of which saw their credit lines cut off by banks during the financial crisis, struggle to access credit. And, the banks to which Congress pledged $30 billion of taxpayer money as an incentive to lend to small businesses have certainly not embraced that opportunity, leaving two-thirds of this money unclaimed.

[1] CUNA is the nation's largest credit union advocacy organization representing nearly 90% of America's 7,300 state and federally chartered credit unions and their 93 million members.

As everyone agrees, more needs to be done to help America's small businesses. Credit unions can help if Congress enacts S. 509, the Small Business Lending Enhancement Act. This much needed, commonsense 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 first year, helping them to create 140,000 new jobs, without an outlay of a single taxpayer dollar.[2]

My testimony today will discuss: credit union business lending activity since the *Credit Union Membership Access Act* (P.L. 105-219), which imposed a statutory cap on credit union business lending, was enacted in 1998; the need for additional business lending in today's economy; legislation (S. 509 / H.R. 1418) which has been introduced and endorsed by the Administration, to increase the credit union member business

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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).

lending cap; the impact of the legislation on federal revenues; and, the objections to this legislation raised by the banking trade associations.

Credit Union Business Lending since the Enactment of the Credit Union Membership Access Act

The number of U.S. credit unions has declined significantly since 1998 – a trend which mirrors the consolidation occurring in the banking industry.[3] One result of the trend to fewer, but larger, institutions is that more credit unions now have the resources to be active business lenders.

At the end of 1998, 1,540 U.S. credit unions – 14% of the nation's 13,000 credit unions – reported member business loans on their balance sheets; member business loans represented only 3% of total loans at offering institutions (or 1% of total credit union loans). Today, 2,200 credit unions – or 30% of all credit unions – report member business loans on their balance sheets. These loans now represent 8% of total loans at offering institutions (or 7% of total credit union loans).[4]

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[3] FDIC reports reveal that the number of banking institutions declined by 28% since 1998 - from 10,464 at year-end 1998 to 7,574 at the end of March 2011. NCUA and CUNA data shows that the number of credit unions declined by 34% (from 11,225 at year-end 1998 to 7,423 at the end of March 2011). In both industries, mergers were the primary driver of the decline in number of institutions.

[4] NCUA and CUNA Policy Analysis. It is important to note that these statistics understate the true involvement of credit unions in the business lending arena. The *Federal Credit Union Act* defines "member business loan" to exclude loans "made to a borrower or associated member that has a total of all such extensions of credit in an amount equal to less than $50,000". Thus, credit unions generally do not include loans for business purposes that are under this $50,000 threshold as "member business loans" on their call report filings.

Credit Union Member Business Lending Trends

Year	Number of US CUs	Percent of CUs Offering	Number Offering	Percent of Movement Tot. Loans	Percent of Offering CU Tot. Loans
1998	11,225	13.8	1,543	1.39	3.24
1999	10,862	14.1	1,526	1.48	3.43
2000	10,536	14.6	1,540	1.57	3.49
2001	10,206	15.4	1,575	1.71	3.55
2002	9,898	16.5	1,633	2.08	3.89
2003	9,574	17.5	1,678	2.53	4.57
2004	9,209	18.8	1,728	3.41	5.27
2005	8,877	21.3	1,892	4.09	5.80
2006	8,535	23.2	1,979	4.72	6.30
2007	8,268	25.2	2,083	5.18	6.61
2008	7,965	27.2	2,170	5.74	7.10
2009	7,708	28.7	2,208	6.23	7.61
2010	7,486	30.2	2,261	6.70	8.04
3/11	7,423	29.6	2,197	6.80	8.02

Source: NCUA and CUNA Policy Analysis.

Credit union member business loans have grown significantly in recent years. In fact, total member business loans at credit unions have grown from $3.5 billion in 1998 to $38.7 billion at the end of March 2011 – more than a tenfold increase since the arbitrary 12.25% cap was imposed.[5]

Credit Union Member Business Loan Totals and Growth

Year	$ Amount Outstanding ($ Mil)	Percent Change in MBLs Outstanding	Amount Granted ($ Mil)	Percent Change in MBLs Granted
1998	$3,462	15.9	$1,563	21.6
1999	$4,097	18.3	$1,816	16.2
2000	$4,821	17.7	$2,000	10.1
2001	$5,613	16.4	$2,839	41.9
2002	$7,325	30.5	$4,215	48.5
2003	$9,731	32.9	$6,189	46.8
2004	$14,486	48.9	$8,438	36.3
2005	$19,234	32.8	$9,453	12.0
2006	$23,911	24.3	$11,182	18.3
2007	$27,970	17.0	$12,050	7.8
2008	$33,037	18.1	$13,888	15.3
2009	$36,312	9.9	$11,100	-20.1
2010	$38,500	6.0	$12,436	12.0
3/11	$38,662	1.7	$12,772	10.8

Source: NCUA and CUNA Policy Analysis. 3/11 growth is annualized.

Since 1998, credit union member business loans have grown at an average annual rate of 22% – more than three times faster than the 7% average annual growth rate of all credit union loans over the same period. In addition, credit union business loan growth

[5] Ibid.

has outpaced growth in other areas of the credit union loan portfolio in all but two years since 1998: credit union mortgage loans grew marginally faster than business loans in both 1998 and 2001.[6]

While member business lending has been growing quickly, credit unions remain a small player in the overall business lending market. In 1998, credit union member business loans represented only 0.2% of total depository business loans, a share that grew to 1.4% by March 2011. Of course, the average size of credit union member business loans – \$223,000 – is a clear reflection of the fact that these are truly loans to small businesses.[7] If all credit union member business loans outstanding were considered "small business loans," we find that credit unions 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.[8]

The data make it clear: credit unions represent a fast-growing but small presence in the business loan marketplace. Credit unions clearly are not a threat to commercial banking interests.

Credit unions have a long history of engaging in safe and sound business lending – they have been making these loans since their inception in the United States over 100 years ago. And, credit unions have expanded their member business lending portfolios carefully and prudently.

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[6] Ibid.

[7] Excludes loans for business purposes of less than \$50,000.

[8] FDIC, NCUA and CUNA Policy Analysis.

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 quarter 2011, the credit union member business loan net charge-off rate of 1.18% remained lower than the net charge-off rate on credit union consumer loans (1.64%) and was only marginally higher than the net charge-off rate on total credit union loans (1.10%).[9]

Credit union business lending also reflects substantially greater strength than business lending at other financial institutions. Since 1998, credit union member business loan net charge-offs rates have been roughly one-fourth the bank average (0.26% vs. 0.95%). 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 quarter of 2011 credit union MBL annualized net charge-offs remained about equal to bank rate (1.18% vs. 1.14%) even though the bank rate declined dramatically in the most recent quarter.[10]

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[9] NCUA and CUNA Policy Analysis.
[10] FDIC, NCUA and CUNA Policy Analysis.

Business Loan Asset Quality Comparisons

	Net Chargeoffs	
	Credit Union MBLs	Commercial Bank Commercial & Industrial Loans
1998	0.08%	0.43%
1999	0.12%	0.57%
2000	0.05%	0.01%
2001	0.10%	1.43%
2002	0.09%	1.76%
2003	0.08%	1.26%
2004	0.10%	0.50%
2005	0.05%	0.27%
2006	0.08%	0.30%
2007	0.09%	0.52%
2008	0.33%	1.01%
2009	0.59%	2.36%
2010	0.74%	1.75%
1st Qtr. 2011	1.18%	1.14%
Avg. since '98	**0.26%**	**0.95%**

Source: FDIC, NCUA, and CUNA E&S. 1st Quarter 2011 results are annualized.

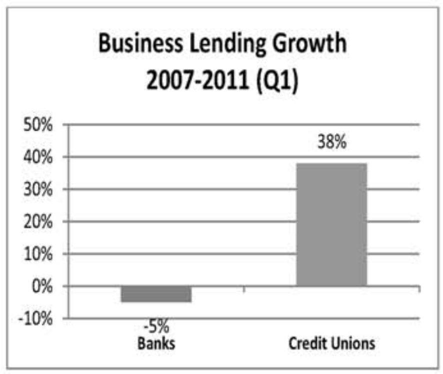
Member business lending at the nation's credit unions has been strong since the enactment of the *Credit Union Membership Access Act*. Since the beginning of the financial crisis, the growth has been nothing short of remarkable. Moreover, credit unions have demonstrated the ability to do this type of lending safely and soundly, especially in comparison to for-profit lenders.

The Need for Reform

Anecdotal evidence – reports we get from our member-credit unions – reveals that small business owners were (and are) being turned away by their banks in large numbers. Those with longstanding relationships with banking institutions have been left without access to capital at a time when they – and the economy – need it most.[11]

[11] Note that the National Federation of Independent Business (NFIB) reports that low sales remain the number-one concern of small businesses. However, throughout 2010, NFIB surveys consistently showed that the percent of small businesses that claimed that they did not have their financing needs met was double the percentage that answered similarly in 2005-2006. The current level of borrowing success remains significantly lower than in the mid-2000s when the NFIB found that up to 90 percent had their credit requests approved.

While other lenders pulled back and hunkered down during the financial crisis, credit unions stepped to the plate and continued to lend to the nation's small businesses. In fact, total credit union business loans increased by 38% since December 2007 while bank business loans decreased by 5% over the same period.[12]



Even today, banks – both large and small – continue to turn away many business borrowers. Bank business loans declined by 4% in the year ending March 2011 and small banks – those with less than $1 billion in assets - saw a decline of 2% during the same period. In contrast, credit union business loans grew by 5% during the period.[13] What these numbers show clearly is that if institutions were willing and able to lend to small businesses during the financial crisis, there was plenty of demand for the loans.

While it is true that member business loans have grown quickly since 1998, it also is true that the strong historical growth rate has been slowing substantially recently. One

[12] FDIC, NCUA and CUNA Policy Analysis.
[13] Ibid.

important reason for this slowdown is that an increasing number of credit unions are approaching the 12.25% statutory cap.

There are now 334 credit unions that are nearing the cap.[14] While they represent just 16% of non-grandfathered credit union business lenders, they account for fully 51% of all business loans subject to the 12.25% cap. They have been the major contributors to credit union member business loan growth over the past few years. In addition, the 144 credit unions that are closest to the cap (those with 10% to 12.5% of assets in member business loans) hold one-quarter of MBLs at non-grandfathered credit unions but have less than $1 billion in unused capacity under the cap. Over the next few years, the growth among these credit unions will dry up without an increase in the cap.[15]

The cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but also discourages credit unions who would like to enter the business lending market. 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 the MBL arena. Indeed, over two-thirds 68% of the nation's 7,400 credit unions have $45 million or less

[14] Non-grandfathered credit unions with MBL-to-asset ratios greater than 7.5% of assets.
[15] NCUA and CUNA Policy Analysis.

in total assets but only 530 credit unions this size (25% of MBL credit unions) are involved in member business lending. 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 approximately \$170,000 in income but would generate 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.).[16] 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.

The impact of the credit union member business lending cap on small businesses is seen at credit unions like Listerhill Credit Union in Sheffield, Alabama.[17]

Just a few years ago, Listerhill Credit Union had a member who worked in the barge terminal industry who had an opportunity to operate his own barge terminal in the Port of Florence, AL on the Tennessee River. His request for financing was denied by every bank in town (six of them at least), despite having an outstanding credit score and

[16] 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.
[17] Founded in 1952 by 7 employees of Reynolds Metals plant who started the credit union by depositing \$5 each, Listerhill Credit Union has grown to \$520 million in assets today by fulfilling its mission of service to its members, including to members who have their own small businesses.

significant experience in the business. He was ultimately referred by a friend to Listerhill Credit Union which granted a loan of around $200,000.

Because of this loan from the credit union, the borrower was able to open a barge terminal in port that does stevedoring (loading and off-loading of barges) and barge maintenance repair. His business has been successful and now employs four other workers. Last year, this small business owner had the opportunity to purchase an additional tugboat to expand and do work offsite. This would have doubled his business and meant hiring an additional three people. Unfortunately, Listerhill Credit Union had to deny his request for the sole reason that it was already against the statutory cap on member business loans. The business owner estimates that the lost opportunity cost him between $200,000 and $250,000 in additional revenue during the recent economic recession.

Listerhill Credit Union currently manages and maintains a member business loan portfolio of near $50 million with no delinquencies and one charged-off member business loan in their history.

Mr. Chairman, credit unions like Listerhill are serving the needs of their business-owning members in every state of the Union. Credit unions have the capital to lend. They have the willingness to lend. They need Congress to let them lend. Allowing credit unions to extend member business loans to those who need credit will add fuel to help create a self-sustaining economic expansion.

S. 509 – The Small Business Lending Enhancement Act

Senators Mark Udall, Olympia Snowe and Charles Schumer, have introduced legislation (S. 509) which, if enacted, would increase the credit union member business lending cap from the current level of 12.25% of total assets to 27.5% of total assets.[18] Similar legislation (H.R. 1418) has been introduced in the House of Representatives by Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY).

The Udall-Snowe-Schumer bill, which the Administration supports, establishes a two-tier structure for the credit union member business lending cap. Tier One credit unions would be eligible to engage in business lending up to the current cap of 12.25% of total assets. Tier Two credit unions would have to meet even more statutory and regulatory criteria and be approved by NCUA, and only then would they be permitted to engage in additional business lending up to 27.5% of total assets. In order for a credit union to be considered for Tier Two status, the credit union would have to:

- be well-capitalized (currently, at least 7% net worth ratio);
- be at or above 80% of the Tier One cap for one year prior to applying for approval;

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[18] S. 509 has also been cosponsored by Senators Boxer, Brown (OH), Collins, Franken, Gillibrand, Leahy, Lieberman, Nelson, Reed, Whitehouse, Wyden, Stabenow, Levin, Sanders, Inouye, and Reid.

- have engaged in member business lending for five years prior to applying; and
- be able to demonstrate sound underwriting and servicing based on historical performance; strong management, adequate capacity to lend, and policies to manage increased business lending.

Under S. 509, Tier Two credit unions would be required to phase in additional business lending by limiting a Tier Two credit union's business lending portfolio growth to no more than 30% per year. NCUA would approve a credit union for Tier Two status using statutory standards, set by Congress, not the regulator. 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, S. 509 directs NCUA and the Government Accountability Office to conduct separate studies of credit union business lending and report to Congress three years after enactment.

S. 509 would permit credit unions to help small businesses in need of credit while at the same time ensuring that credit unions engaging in additional business lending are continuing to do so safely and soundly. Many of the new features of this proposal address safety and soundness, and will safeguard the NCUSIF against increased exposure.

As noted above, we estimate that if this proposal were enacted into law, credit unions could lend an additional $13 billion to small businesses in the first year after implementation, helping small businesses create as many as 140,000 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 small business and public policy groups have signed an open letter urging Congress to enact the Udall-Snowe-Schumer bill including: the Americans for Tax Reform, 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, NCB Capital Impact, National Association of Professional Insurance Agents, National Association for the Self-Employed, National Council of Textile Organizations, National Association of Realtors®, Council for Insurance Agents and Brokers, Center on Risk, Regulation and Markets at the Heartland Institute, and the Association for Manufacturing Technology.

Addressing the Congressional Budget Office Score

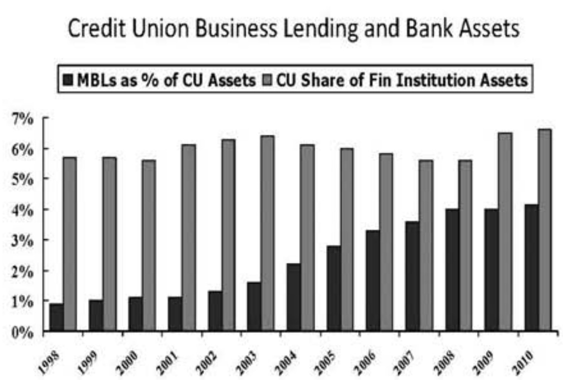
We understand that the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) were asked to score the cost of an identical bill (S. 2919) introduced by Senator Udall in the 111th Congress, and that the estimated revenue losses ranged from $4 million in 2012 to $65 million in 2020. The total of the estimates from 2010 to 2015 is $77 million; from 2010 to 2020 it is $354 million. CBO provided the following explanation for the estimates of the Statutory Pay-As-You-Go Impact:

> S. 2919 would increase the cap on business loans made and held by certain credit unions. As a result, some assets would be shifted from taxable financial institutions to credit unions, which are generally exempt from federal income taxes. The estimate of revenue losses as shown in the table was prepared by staff of the Joint Committee on Taxation.

Based on this explanation, we expect that JCT derived the tax loss estimates on the basis of estimates of or assumptions about the following factors:

- The amount of new business lending that would be undertaken by credit unions through 2020 as a result of lifting the lending cap.
- The amount of that new business lending that would represent a transfer of assets from taxed banks to untaxed credit unions, i.e., replacing bank lending with credit union lending.
- The income banks would have earned on those assets.
- The average effective tax rate paid by banks.

If indeed this is how the analysis was conducted, we offer the following observations. The historical record does not suggest any relationship between the growth of business lending at credit unions and a shifting of assets from banks to credit unions. As the chart below shows, despite a fourfold increase in the proportion of credit union assets held in business loans from 1998 to 2010, the credit union share of the combined assets of credit unions and all banking institutions over the same period has hardly budged, fluctuating in a narrow range around 6%. There are likely two reasons for this phenomenon.



Combined assets include credit unions and all banking institutions (commercial banks and thrifts.)

Sources: FDIC, NCUA., and CUNA Economics and Statistics

First, it is likely the case that many of the business loans made by credit unions would not have otherwise have been made by banks or other taxable lenders. Many of the loans might be too small or non-standard for banks, or the borrowers may not feel comfortable applying to a commercial bank. Therefore, the proportion of banks loans that would be "crowded out" by credit union loans would be easy to overestimate.

Second, given the typical operation of a community bank, the size of the institution is determined less by its loans than by its deposits. Unlike large, money center banks that can readily vary their funding levels by borrowing or issuing negotiable CDs, community banks are largely funded by retail and small business deposits, much of them core deposits. These funding sources are much less controllable by the bank. Typically, large banks arrange whatever liabilities are necessary to fund their available assets whereas community banks instead deploy whatever deposits are available into the most advantageous assets. To the extent credit union business lending – which is typically made up of relatively small loans – does crowd out bank business lending, it would mostly be from smaller banks, which would not actively shrink their assets as a result. The only effect on bank assets would be if some business borrowers transferred some deposits from banks to credit unions. The relevant factor is less the amount of assets transferred from banks to credit unions than it is the amount of bank assets that would be deployed into bank investments in securities rather than in bank loans as a result of reduced business lending. Therefore, estimates of lost tax revenue should be based primarily on the difference between the net rates of return on bank business lending and bank investments, applied to the reduction in business lending. Since the net return on bank investments is likely to be substantially above zero for most of the period of analysis, the reduction in bank taxable income would be much less than that calculated if the bank were assumed to shrink by the amount of the reduced business lending.

Finally, considering only the tax loss from reduced bank profits ignores the simultaneous tax gain to Treasury from businesses that borrow from credit unions instead of banks. Because credit unions typically charge less than banks on loans, a business that borrows from a credit union is likely to pay a lower interest rate than it would at a bank. This increases the taxable income of the business by reducing its deduction for interest expense. We do not have specific data on interest rates on business loans at credit unions compared to banks. However, across the board, credit unions charge lower loan rates, fewer and lower fees, and pay higher rates on deposits than do banks. This is evidenced by the lower return on assets (net income divided by assets) at credit unions compared to banks. The credit union return on assets is typically about a percentage point below that at banks. Assuming about 40% of that goes to savers and 20% comes from lower fees, that leaves around 40 basis points, on average, in lower loan rates. This is part of the cooperative advantage. Therefore, on those new business loans made by credit unions that would otherwise have been made by taxable lenders, the same transaction that reduces the taxable income of the bank increases the taxable income of the borrower (reasonably approximated by a 40 basis point reduction in deductible interest expense).

To the extent any of these factors were not taken into account in JTC's estimate of the tax revenue effects of S. 509, the revenue estimates would be overstated. Once all of these factors are included in the analysis, the overall score for the bill would likely be reduced substantially.

We believe in practice, an increase in the credit union member business lending cap would actually reduce the federal deficit because the new business loans that did not crowd out bank lending would stimulate growth at small businesses, increase employment and incomes, and hence tax revenues.[19]

Only the Bankers Oppose Credit Union Business Lending and Their Objections Do Not Hold Water

[19] The points we raise above ignore these dynamic effects, instead complying strictly with the "fixed GNP constraint."

The Udall-Snowe-Schumer bill attempts to address a very significant public policy problem – the difficulty small businesses are having accessing capital – without increasing risk exposure to the federal government and without outlaying a penny of taxpayer money.

As Senator Udall has said, "It is hard for me to believe that the government is telling [credit unions] they cannot help create jobs in their local communities."[20]

It is hard for small businesses, credit union employees and volunteers to believe as well. And when they ask me why Congress will not let credit unions do more business lending, there is truly just one answer.

The banks oppose it.

That answer is not good enough for taxpayers who have given the banks $30 billion of their money to lend to small businesses, but have only seen the banks use $9.2 billion (64% of which was requested by TARP recipients).[21] It does not satisfy the small business owner who has been turned down for a loan by multiple banks; it should not satisfy Congress. It should satisfy no one.

There are a lot of reasons to let credit unions do more small business lending – at least 140,000. But there are no sound public policy reasons not to. Failure to expand the credit union member business lending cap would literally leave money on the table that could be loaned to small business.

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[20] Statement of Senator Mark Udall. *Congressional Record*. March 17, 2001. S1785

[21] Office of the Inspector General. Department of Treasury. "Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund." May 13, 2001. 2,7.

The bankers raise a number of objections, but none of them hold water.

The bankers say business lending is not a part of the credit union mission. The facts show that credit unions have been doing business lending since day one.

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, as he encouraged the founding fathers of St. Mary's Bank Credit Union to organize the United States' first credit union:

> "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."[22]

For the first 90 years of credit unions' existence in the United States, there was no statutory business lending cap for credit unions. 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. 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*. However, the Clinton Administration said that there

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[22] *L'Avenir National* (Manchester, N.H.), Vol. XXI, No. 67, 28 November 1908, p. 4-5.

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."[23]

The bankers say increased business lending would undermine credit union safety and soundness.

As we have noted above, the facts show that credit unions do this type of lending more safely and soundly than the banks; the credit union net charge-off rate has been roughly one-fourth the bank average since 1998.

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 credit losses on those loans, will increase credit union earnings, capital contributions, and, importantly, overall safety and soundness.

Credit unions are committed to operating in a safe and sound manner, which is why we sought the guidance of the Department of Treasury and the NCUA in developing legislation to increase the credit union member business lending cap in a manner that does not jeopardize credit union safety and soundness. We believe it is very significant that the Udall-Snowe-Schumer bill mirrors a proposal put forward by the Secretary of

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[23] Statement of Administration Policy. H.R. 1151 (105th Congress). July 22, 1998.

Treasury to raise the credit union business lending cap and includes additional safeguards that not only protect the taxpayer, but also all credit unions which jointly fund the National Credit Union Share Insurance Fund.[24]

The bankers say increasing the cap will only affect a small number of credit unions while at the same time claiming that increasing the cap will hurt community banks.

It is a contradiction – and the bankers are wrong on both counts.

The member business lending cap affects every credit union that has a member who looks to them for financing a new or existing small business. Some have active business lending programs; others do not engage in business lending because they view the cap an impediment that does not justify the sizeable up-front investment necessary provide a sound business lending program in the first place.

As noted above, member business loans have been the fastest growing component of credit union lending every year since 2001. That growth in credit union member business loans is now slowing as more and more credit unions approach their caps. The credit unions that are now near the cap account for over half of the business loans subject to the cap. Having been there for their small business-owning members over the last several years, these credit unions will see their ability to continue this service diminish in the absence of Congressional action to increase the business lending cap.

[24] A copy of Secretary Geithner's letter regarding this proposal is attached to this testimony.

Increasing the cap will have a profound effect on the hundreds of credit unions that will reach the cap in the next few years, but it will not adversely affect the banker dominance of the market for small commercial loans – currently at 94%. In fact, credit union member business lending actually helps local communities, including community banks, by stabilizing the local economy and creating jobs.

Economic theory is revealing as to whether 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.[25] This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using the Fed estimate, and considering that credit unions currently hold on average only about 6% of the small business loans held by depository institutions, and that S. 509 would limit annual business loan growth above the old cap to 30%, if credit unions entered the market lowering interest rates by roughly one percentage point, the lion's share of that new lending could be accomplished without any reduction in bank loans.

[25] 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.

The bankers say that increased credit union business lending will lead to a reduction of other types of credit union lending.

Increasing the cap – rather than removing the cap – guarantees that the increases in member business lending would be accomplished while credit unions remain primarily focused on consumer lending. The average loan-to-asset ratio at credit unions that offer business loans is 60%. Accounting for the roughly 5% of assets in fixed and other assets, that leaves about 35% of assets in cash and investments. If the member business lending cap was to be increased, and an additional 15.25% of assets were eventually devoted to business lending, credit unions could fund the increase almost exclusively out of investment holdings, while still maintaining plenty of liquidity.

The bankers say that credit unions should not be granted an expansion of powers because of their tax status.

This specious and sidetracking argument ignores the fact that roughly 2,500 banks are Subchapter S institutions, and, like credit unions, have been afforded special federal income tax treatment by Congress. It is more than a little disingenuous for the bankers to use the credit union tax status as an argument against increasing the credit union member business lending cap when one-third of all banks as Subchapter S corporations are exempt from federal income tax; the bankers recently received a $30 billion subsidy of their business lending activities; credit unions have not cost the taxpayer a dime; credit unions fund their own share insurance fund; and, no credit union member has ever lost a dollar of insured deposits in a federally insured credit union.

Unfortunately, the bankers' correlation of the tax status and the member business lending cap reveals not only their hypocrisy but also their willful misrepresentation and ignorance of the credit union tax status. The credit union tax status, which has been reaffirmed by Congress several times, is based on the structure of credit unions as not-for-profit, democratically-controlled cooperatives. That structure has not changed for the past 100 years. The tax status has nothing to do with the breadth or volume of credit union products or service offerings.

The bankers say that increased business lending will distract credit unions from serving the underserved and call into question the credit union industry's commitment and ability to serve the needs of lower-income and un-banked populations.

In this country, there are many who are underserved, and the credit union record on serving the underserved is well demonstrated. Home Mortgage Disclosure Act (HMDA) data clearly and consistently show that compared to banks, credit unions make a greater percentage of their loans to lower income individuals and that lower income households are much more likely to be approved for loans at credit unions while much less likely to be denied a loan at credit unions. Credit unions have repeatedly attempted to reach out to serve more individuals in lower-income households. However, bankers have used the courts to bar those efforts. The banker tactic of claiming that credit unions are not "doing enough", while erecting obstacles to the provision of credit unions' service, does nothing to help these communities.

As we recover from the Great Recession, *small businesses are underserved.* Bank business lending portfolios have shrunk while credit unions' have increased. Many modest means individuals run small businesses and need credit. This is especially true in recessions because unemployed and discouraged jobseekers are more likely to form businesses during these events. Credit unions want to meet the needs of their business-owning members, and the last Treasury study on credit union member business lending found that credit union loans to small businesses go disproportionately to business owners on the lower end of the income scale.[26]

The bankers say that there is no evidence to support the contention that credit for small business is in short supply and that community banks have been lending throughout the crisis.

As noted above, small business surveys have indicated that more small businesses indicate their financing needs are not being met than in 2005-2006 and borrower approvals remain significantly lower than when nine out of ten borrowers had their credit requests approved. Additionally, many small business owners are telling policymakers that they are being turned away by their banks – a primary reason that Congress gave the banks access to $30 billion taxpayer dollars last year. Banks – both large and small – have turned away many business borrowers during the crisis, despite significant demand for capital. As noted, from December 2007 through March 2011, total bank business lending declined by 5% while credit union business lending increased by 38%. Allowing credit unions to extend member business loans to those who need credit will add fuel to a self-sustaining economic expansion.

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

The time is now to set expose the bankers' arguments for what they are -- groundless rhetoric. We urge Congress to permit credit unions to do what they were established to do – serve their members, including those who own small businesses. We have the willingness to help. We have the capacity to help. But, we need Congress to act.

Mr. Chairman, thank you very much for the opportunity to testify today. I am happy to answer any questions the members of the Committee may have.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

May 25, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank:

This letter responds to your request for the views of the Treasury Department concerning current limits on the total amount a credit union can loan in the form of business loans to credit union members. In general, credit unions may make member business loans within a current statutory limit: loans cannot exceed the lesser of 1.75 times the credit union's net worth or 12.25 percent of its total assets. Various proposals have been made to allow for additional lending, such as to raise the limit to 25 percent of total assets with no net worth ratio, as well as to redefine the type of loans that count toward the limit, effectively raising the overall amount of loans even further.

As you know, Representative Kanjorski introduced the *Promoting Lending to America's Small Businesses Act of 2009* (H.R. 3380) and a companion bill has been introduced in the Senate by Senator Udall and others.

The Treasury Department could support proposals to increase credit union member business lending provided safety and soundness concerns are addressed. It is important that reforms are not done in a way that inappropriately introduces more risk to credit union members, the credit union system, the National Credit Union Share Insurance Fund, or the financial system as a whole. Treasury will work with the Congress on legislative proposals that include sufficient safeguards.

One approach would be to maintain the current limit for most credit unions but increase the limit for credit unions that meet certain high standards. In particular, the cap could be raised for credit unions that: (1) have been near the current limit for four consecutive quarters (for example, credit unions with member business loans totaling eighty percent of the amount allowed); (2) are well capitalized; (3) have no less than five years of experience of underwriting and servicing member business loans; (4) have strong policies and experience in managing member business loans; and, (5) satisfy other standards established by the National Credit Union Administration (NCUA) to maintain the safety and soundness of credit unions.

We would support allowing credit unions that meet these high standards to increase lending above the current limit, but the new limit should be no higher than 27.5 percent of total assets. In addition, safeguards should be in place that safeguard against eligible credit unions increasing their member business loans too quickly. We would suggest that member business loan growth for eligible credit unions be limited to no more than thirty percent annually. In addition, the NCUA should be given the authority to set rules creating intermediate member business loan limits and to require approval before any credit union can move to the next higher limit.

Moreover, if a credit union should become less than well capitalized, it should be required to cease member business lending and only resume such lending upon its return to a well capitalized position after regulatory approval. Finally, the NCUA should be vigilant and carefully oversee implementation and there should be reporting on member business lending activity and loan performance. Legislative language is enclosed which reflects this approach and addresses safety and soundness concerns.

We are willing to continue to work with the Congress on legislation that would meet these objectives.

Sincerely,

Timothy F. Geithner

Enclosure

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Increased Options for Small Business Lending Act of 2010''.

SEC. 2. LIMITS ON MEMBER BUSINESS LOANS.

(a) REVISED LIMITATION AND CRITERIA.—Effective 6 months after the date of enactment of this Act, section 107A(a) of the Federal Credit Union Act (12 U.S.C. 1757a(a)) is amended to read as follows:

''(a) LIMITATION.—

''(1) IN GENERAL.—No insured credit union may make any member business loan that would result in the total amount of such loans outstanding at that credit union at any one time equal to more than the lesser of 1.75 times the actual net worth of the credit union or 12.25 percent of the total assets of the credit union, except as provided in paragraph (2).

''(2) ADDITIONAL AUTHORITY.—The Board may approve an application of a credit union upon a finding that the credit union meets the criteria under this paragraph to make one or more member business loans that would result in a total amount of such outstanding loans at any one time of not more than 27.5 percent of the total assets of the credit union, only if the credit union—

''(A) had member business loans outstanding at the end of each of the 4 consecutive quarters immediately preceding the date of its application, in a total amount of not less than 80 percent of its applicable limitation under paragraph (1);

''(B) is well capitalized, as defined in section 216(c)(1)(A);

''(C) can demonstrate at least 5 years of experience of sound underwriting and servicing of member business loans;

''(D) has the requisite policies and experience in managing member business loans; and

"(E) has satisfied other standards that the Board determines are necessary to maintain the safety and soundness of the insured credit union.''.

(b) CREDIT UNIONS THAT ARE NO LONGER WELL CAPITALIZED.—Effective 6 months after the date of enactment of this Act, section 107A of the Federal Credit Union Act (12 U.S.C. 1757a) is amended by adding at the end the following:

''(f) EFFECT OF NOT BEING WELL-CAPITALIZED.—

Notwithstanding subsection (a), an insured credit union that has made member business loans under the limitation in subsection (a)(2) and that is not, as of its most recent quarterly call report, well capitalized (as defined in section 216(c)(1)(A)), shall not make any new member business loans, until such time as the credit union becomes well capitalized, as reflected in a subsequent quarterly call report, and obtains approval from the Board.''.

SEC. 3. IMPLEMENTATION.

(a) TIERED APPROVAL PROCESS.—The National Credit Union Administration Board shall develop a tiered approval process, whereby federally insured credit unions gradually increase the amount of member business lending in a manner that is consistent with safe and sound operations, subject to the limit established under section 107 A(a)(2) of the Federal Credit Union Act (as amended by this Act), provided that such rate of increase shall not exceed 30 percent per year.

(b) RULEMAKING REQUIRED.—The National Credit Union Administration Board shall issue proposed rules, not later than 6 months after the date of enactment of this Act, to establish the tiered approval process required by subsection (a). The tiered approval process shall establish standards which seek to ensure that the new business lending capacity provided by section 2 is being used only by federally insured credit unions that are well-managed and well-capitalized, as required by the amendments made by section 2, and as defined in such rules by the National Credit Union Administration Board, consistent with the safety and soundness thereof.

(c) CONSIDERATIONS.—In issuing rules required by this section, the National Credit Union Administration Board shall consider—

(1) the experience level of the institutions, including a demonstrated history of sound member business lending;

(2) the criteria under section 107 A(a)(2) of the Federal Credit Union Act, as amended by this Act; and

(3) such other factors as the Board may deem necessary or appropriate.

SEC. 4. REPORTS TO CONGRESS ON MEMBER BUSINESS LENDING.

(a) REPORT OF THE BOARD.—

(1) IN GENERAL.—Not later than 3 years after the date of enactment of this Act, the National Credit Union Administration Board shall submit a report to Congress on member business lending by federally insured credit unions.

(2) REPORT.—The report required by paragraph (1) shall include—

(A) the types and asset size of credit unions making member business loans and their applicable member business loan limitations;

(B) the overall amount and average size of member business loans by each credit union;

(C) the ratio of member business loans to total assets and net worth;

(D) the performance of the member business loans, including delinquencies and net charge offs;

(E) the effect of this Act on the number of credit unions engaged in member business lending, any change in the amount of member business lending, and the extent to which any increase is attributed to the change in the limitation in section 107A(a) of the Federal Credit Union Act, as amended by this Act;

(F) the number, types, and asset size of credit unions that were denied or approved by the Board for increased member business loans under section 107A(a)(2), as amended by this Act, including denials and approvals under the tiered approval process;

(G) the types and sizes of businesses that receive member business loans, the duration of their credit union membership at the time of the loan, the types of collateral used to secure member business loans, and the income level of members receiving member business loans; and

(H) the effect of any increases in member business loans on the risk to the National Credit Union Share Insurance Fund and the assessments on insured credit unions.

(b) GAO STUDY AND REPORT.—

(1) STUDY.—The Comptroller General of the United States shall conduct a study on the status of member business lending by federally insured credit unions, including—

(A) trends in such lending;

(B) types and amounts of member business loans;

(C) the effectiveness of this Act in enhancing small business lending;

(D) recommendations for legislative action, if any, with respect to such lending; and

(E) any other information that the Comptroller General considers relevant with respect to such lending.

(2) REPORT.—Not later than 3 years after the date of enactment of this Act, the Comptroller General shall submit a report to Congress on the study required by paragraph (1).

PREPARED STATEMENT OF NOAH WILCOX

PRESIDENT AND CHIEF EXECUTIVE OFFICER, GRAND RAPIDS STATE BANK, ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

JUNE 16, 2011

Opening

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I am Noah Wilcox, fourth generation President and CEO of Grand Rapids State Bank and a member of the Executive Committee of the Independent Community Bankers of America. Grand Rapids State Bank is a State chartered community bank with $236 million in assets located in Grand Rapids, Minnesota. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on credit union member business lending.

ICBA appreciates this opportunity to testify on legislation (S. 509) that would expand credit union powers by raising the cap on member business loans as a percentage of assets. We strongly oppose the Small Business Lending Enhancement Act. 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 nonprofit organizations. I have served on a number of nonprofit boards, including the Grand Rapids Area Community Foundation and the Itasca County Family YMCA. Many of my community bank colleagues perform similar service. These nonprofits 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.

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. I have very aggressive credit unions in my market. On countless occasions, I've lost business lending opportunities with established customers to credit unions who underpriced my competitive rates. Just last Friday, as I was preparing for this hearing, a longtime customer, with both personal and commercial lending relationships, told me they were taking three loans to two different credit unions. One of the loans was a loan on real estate for development that the credit union priced about 400 basis points less than our rate, which is competitive. This rate is even lower than can be accounted for by the tax advantage, suggesting that the credit union, inexperienced in business lending, did not appropriately price the risk. The second loan is a small commercial loan. And the third loan is a mortgage on the borrower's residence, on which, though it does not qualify for the secondary market, the credit union, has offered a rate in the mid- 3-percent range.

S. 509 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. The 1998 law reversed a recent Supreme Court decision and allowed credit unions to serve a customer base with multiple common bonds. Because the law made the common bond requirement nearly meaningless, the member business lending cap was deemed especially important to maintain a distinction between credit unions and 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 S. 509 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—we estimate this number to be about 0.5 percent of the approximately 7,400 credit unions. 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, speculative, commercial loans—not small business loans. There is ample capacity for the remaining 99.5 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 S. 509—does not suggest that the current cap of 12.25 percent is too low. What's more, there are numerous exceptions to the member business lending cap, including:

- Any loan of less than $50,000;
- Small Business Administration loans, including 7(a) and 504 SBA loans of up to $5 million;
- Nonmember 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 S. 509 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 irresponsible at best.

S. 509 is not driven by the need to bring credit to small businesses. It 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.

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. I recognize that S. 509 includes provisions that are intended to ensure that credit unions have a track record—however limited—in commercial lending. These 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 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 to serve low and moderate income families and into risky business loans. 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? Congress cannot allow tax-exempt credit unions so 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 S. 509 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 must consider the cost-benefit analysis of the credit union tax exemption.

The most comprehensive analysis of the credit union's Federal tax exemption was undertaken by the nonpartisan Tax Foundation in 2005. 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 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 10-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. Eleven 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. This is what I see repeatedly in my business. The credit union loan that I mentioned earlier, that was underpriced by 400 basis points, was surely made possible by the tax subsidy, and perhaps a failure to adequately evaluate the risk. 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.

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 have no distinct business model verses commercial banks than 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 S. 509 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 S. 509 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 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.

PREPARED STATEMENT OF MICHAEL LUSSIER

PRESIDENT AND CHIEF EXECUTIVE OFFICER, WEBSTER FIRST FEDERAL CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

JUNE 16, 2011

Introduction

Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. My name is Mike Lussier and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU) where I currently serve as Chairman of the Board of Directors. I appreciate the opportunity to share my views with the Committee on credit unions and member business lending. I have served as President/CEO of Webster First Federal Credit Union (Webster First), headquartered in Worcester, Massachusetts, since 1990. I earned my Bachelor's of Business Administration, majoring in Accounting from Bentley College and my Master's of Finance from Nichols College.

Webster First is a community credit union with over 44,000 members and more than $570 million in assets. Founded as a Polish-ethnic credit union in January of 1928, Webster First changed to a community credit union in 1956 and became federally chartered in 1995.

Throughout my career, I have been active in the credit union community. Prior to my chairmanship, I served on the Executive Committee of the NAFCU Board. Additionally, I have been a member of the Small Business Loan Review Board, was a Director for the Credit Union League of Massachusetts Insurance Agency, and served as Chairman of the Massachusetts Share Insurance Corporation Board.

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 and allowing credit unions to further assist in the economic recovery.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. 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.

Credit unions are not banks; they are better. 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. 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 Senators Tester and Corker, and those who supported their 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, they put in place restrictions on the ability of credit unions to offer member business loans. 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. 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).

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 nearly 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 $69,000, using the May consumer price index data. That is a 38 percent 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.

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 with 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 1st quarter 2011 call report data shows that credit unions with MBL's have the same annualized net charge-off rate for business loans (1.12 percent) as commercial lending banks. Furthermore, they are actually better equipped for the charge-offs as they have a higher coverage of delinquent loans with their allowance account (101.72 percent) than those commercial lending banks (57.85 percent). NAFCU would welcome the opportunity to appear before the Committee on a hearing on this topic examining the banks.

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 2,377 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 actually 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 message. Perhaps the issue the Committee should be holding hearings on is the unfair advantage banks have over credit unions due to their Subchapter S Federal tax break.

The Arbitrary Cap Today

Credit unions have been critical in helping our country recover from the financial crisis, and members of Congress on both sides of 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. 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 credit union member business lending cap would help provide needed economic stimulus.

Some short-sighted 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 Webster First often 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, because, 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.

Member Business Lending at Webster First FCU

Webster First has been at the outdated and arbitrary credit union member business lending cap for almost a year now. On the business lending side, we offer numerous products including real estate loans, lines of credit, small business equipment loans, auto and truck loans, and a few small stores that do floor plans. We have a well diversified portfolio with minimal delinquencies. Our commercial losses have also been minimal as we have a sincere and devoted membership.

At Webster First, we understand that member business lending is not about credit unions, but about helping small businesses and the jobs they create. It is unfortunate that we cannot handle all the requests we receive due to the outdated and arbitrary member business lending cap. It is with our liquidity, strong surplus, and experienced staff, that Webster First could continue to help the small businesses in our community, many of which feel threatened and treated unfairly by other institutions.

Webster First has made some great in-roads into business lending and has assisted multiple families and businesses in becoming quite successful. For example, we helped an individual purchase an older gas service station from his parents. He was able to upgrade all his pumps, computer services, and revamp his store. It now includes a coffee shop, package store, and a 10 pump service station. His success allowed him to then upgrade the unused property behind the station for storage rental units which quickly became 90 percent utilized. He recently sold the property for a substantial profit and has now acquired other properties to expand his business. As the Committee knows, business expansion means job creation.

We have assisted many real estate owners who own multifamily units in refinancing their existing mortgages from other institutions. These institutions refuse to allow them to rewrite due to the fear that real estate values have not hit bottom. Many of these property owners have plenty of cash, net worth and positive cash flow, but the banks they approached for financing declined the entrepreneurs' requests and would not work with them. We put them through an intensive analysis, document their credit and payment history, and have been able to revive the possibility of continued ownership via lesser rates, smaller payments, and continued positive cash flow.

Recently, Latino radio station owner wanted to expand his radio station ownership to acquire some local radio stations in order to better accommodate the Latino market in Worcester. Because of the risk associated with radio stations, many banks would not consider his request. We reviewed the contracts, cash flows, equity position, and collateral, and were able to finance his dream. He is now the largest Latino radio station owner in all of Massachusetts. We have not only assisted this individual, but in working with him, we were also able to increase our marketing and business opportunities within the under-banked community. We have since put a credit union branch in this underserved area.

One of the newest areas we have been able to enter is small-town downtown rehabilitation. We recently hired an individual who is well versed in SBA lending. He is attempting to assist those within our community who may be better served by using our products along with SBA products. As the Committee is aware, guaranteed portions of SBA loans do not count toward the outdated and arbitrary credit union member business lending cap. As the arbitrary cap has hamstrung our efforts to meet the member business lending needs of our membership, SBA loans have at least offered some alternative until the outdated and arbitrary restrictions can be changed.

Credit Union Member Business Lending Legislation in the 112th Congress

In March 2011, Senator Mark Udall of Colorado introduced bipartisan legislation, the Small Business Lending Enhancement Act (S.509), which would raise the arbitrary credit union member business lending cap to 27.5 percent of total assets, up from 12.25 percent, and help stimulate the Nation's struggling economy by increasing access to credit for small business owners. This important legislation has 19 Senate cosponsors, including Majority Leader Reid. Identical legislation (H.R. 1418) has been introduced in the House by Representative Ed Royce of California.

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.

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 percent net worth ratio]; having at least 5 years of member business lending experience; must be at or above 80 percent of the current 12.25 percent 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 sought by Senator Mark Udall last year, when his efforts were endorsed 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, it is worth noting that raising the arbitrary and outdated member business lending cap for credit unions only scores at a cost of $77 million over 5 years according to a 2010 CBO estimate. Furthermore, this cost does not take into account added tax revenue that would be gained from the 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 30 percent of eligible banks have expressed interest in participating. During recent hearings in the Senate Small Business Committee, it came to light that a large number of the banks that have applied for the program also received taxpayer funds from the Troubled Assets Relief Program (TARP). Clearly this effort to promote business lending at community banks has had a lack of success.

Credit unions stand ready to do their part in continuing to assist America's small businesses. Failing to consider legislation to raise the arbitrary member business lending cap last Congress was a missed opportunity to further assist small business 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 Banking Committee and on the Senate floor as soon as possible.

Conclusion

The artificial credit union member business lending cap established in 1998 is arbitrary and outdated. The need for such a cap was questioned by the Treasury Department as far back as 2001. 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 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. NAFCU would also support raising the de minimis $50,000 definition of a member business loan as it has eroded upon enactment last century.

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.

PREPARED STATEMENT OF STEPHEN P. WILSON

CHAIRMAN AND CHIEF EXECUTIVE OFFICER, LCNB NATIONAL BANK, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

JUNE 16, 2011

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, the American Bankers Association appreciates the opportunity to testify at the Senate Banking Committee hearing entitled "Credit Unions: Member Business Loans." The American Bankers Association (ABA) represents banks of all sizes and charters and is the voice for the Nation's $13.4 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 S. 509, 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 and take on significantly more business lending. This would allow a new breed of credit union institutions to more aggressively pursue business customers through large commercial and real estate loans. *It would also serve as an invitation to credit unions that are not near this cap now to focus on business lending—to the exclusion of consumer lending*—in order to be eligible for an increase in their business lending cap.

Under current law, credit unions have an aggregate MBL cap of 12.25 percent of assets. Business loans under $50,000 do not count against this cap of 12.25 percent, nor do many other types business loans—leaving ample room for credit unions to carry out their business lending strategy. There is a limitation on business lending, because credit unions are tax exempt and this tax exemption is meant to be targeted at people of small means.

S. 509 would increase the aggregate business loan cap for qualifying credit unions to 27.5 percent of assets—*more than double the current cap, and greater business lending authority than Federal thrifts.* Thrifts are currently limited to 20 percent of total assets, provided that amounts in excess of 10 percent of total assets may be used only for small business loans. Credit unions would be allowed to further leverage their tax advantage and compete directly with tax-paying banks.

Furthermore, *S. 509 does nothing to protect members' interests with regard to consumer loans*, which would necessarily diminish over time as credit unions add business lending. In other circumstances where a credit union will move its focus away from consumer lending, NCUA requires "a clear and conspicuous disclosure" of this change. 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 S. 509. 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.

A credit union that applies and receives the authority to increase business lending under S. 509 almost certainly would reduce its non- housing-related consumer loans. However, 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.

Make no mistake about it, S. 509 *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 S. 509 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.

Members of Congress have recognized this fundamental problem. As Senator Kerry (D–MA) stated from the Senate floor, credit unions "were never intended to be simply alternative, tax-exempt commercial banks."[1] Other senators have agreed.[2]

Indeed, there is a strong legislative history that supports the unique charter of credit unions *with very specific restrictions on business lending.* These restrictions were put in place to protect credit unions from lending that could pose serious threats to safety and soundness. In addition, they were put in place to ensure that credit unions remained primarily focused on individuals. Even so, the law has always made a place for MBL, although with specific restrictions to keep credit unions focused on the task at hand. In the last debate in 1998 over what that level should be, Senator Reed (D–RI) expressed reservations about the hole that the exemption of loans under $50,000 would create:

> I am concerned that loans under $50,000 would not be counted toward the 12.25 percent cap. As a result, it is possible that credit unions could engage in commercial lending *to a much greater extent* than the limit imposed in the bill.[3] [emphasis added]

This congressional concern 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.* I will address this risk later in my testimony.

Credit unions with strong business lending opportunities can take advantage of these opportunities and 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. 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, formerly Community Credit Union in Plano, TX, which converted 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. I will give more detail on this process later in my testimony.

During this hearing, we will also hear about the loans to very small businesses that credit unions want to make but supposedly cannot. While the rhetoric speaks

[1] Congressional Record, July 28, 1998, S 9095.
[2] Congressional Record, July 28, 1998, S 9019.
[3] Senate Report 105-193, May 21, 1998, p. 29.

of serving the small business man or woman, the reality is that some credit unions are making *larg*e dollar loans to businesses, and now they want to make even larger loans. These new-breed credit unions aggressively pursue business customers through large commercial and real estate loans.

Credit unions' current tax-exempt status and lack of equivalent regulation have created huge competitive inequities in the local marketplace. Some aggressive credit unions have made business lending a top priority as they seek to rapidly grow the institutions—making loans that would be made by taxpaying financial institutions. According to NCUA's own data, today, there are more than 173 credit unions with $1 billion or more in assets, and credit unions with more than $500 million in assets hold 63 percent of the industry's assets. In the majority of the States in this country, a credit union would rank among the top ten banks. As a former president of a State credit union association said: "In a lot of places, credit unions are the major financial institution."[4] Unfortunately, provisions to expand business lending for those credit unions most focused on business lending would further exacerbate these competitive inequities.

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.
- 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.

I. Raising the credit union legal business lending cap is not necessary for credit unions to meet 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.* That means that credit unions start at zero 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. NCUA has aggressively provided additional 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 nonmember 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. The concerns raised by Senator Reed are even more troubling today, as there is even more lending under the radar and outside the limits that Congress had imposed.

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 S. 509. This was acknowledged by NCUA Chairman Deborah Matz last year in a hearing: "It's a small number that are at their cap."[5]

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

[4] "CUs, Banks Put Up Dueling Bills in Oregon", *American Banker,* March 25, 2003.

[5] Senate Committee on Banking, Housing, and Urban Affairs. "State of the Credit Union Industry", December 9, 2010.

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. [6]

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. [7]

Credit unions have good reasons to be concerned. As of March 2011, 4.22 percent of all credit union member business loans were at least 60 days or more past due. An additional $2.1 billion in business loans have been modified. As a concrete example, America First FCU (Riverdale, UT) recently reported that 11.4 percent of its $450 million of member business loans were 12 months or more past due. If America First were regulated by bank regulators, these loans would have been charged off.

Testifying before the Senate Banking Committee on December 9, 2010, 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. [8]

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.* [9]

Since the report was issued, NCUA 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. [10] 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.

Moreover, 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. [11] It should come as no surprise that the Inspector General's Material Loss Review found adequate oversight often missing: business loans were made to nonmembers; 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.*

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[6] "MBL Limits—Be Watchful of What Others Wish For", *Credit Union Times,* February 10, 2010.

[7] "1 deal down, at least 1 to go for Chartway", *Inside Business,* January 11, 2010.

[8] "Telesis' Loan Recoup Attempts Go On", *Credit Union Times,* December 15, 2010.

[9] Appendix A provides more details about what the Inspector General discovered.

[10] "The Rise and Fall of Texans Credit Union", *Dallas Morning News,* May 8, 2011, p. D1.

[11] "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.

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. Additionally, 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 Web site that it recently provided funding for $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." [12]

III. Expanding the business lending cap is inconsistent with the credit union mission of serving consumers, especially those of modest means

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. 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.

A dramatic example of just how far these credit unions have gone 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?

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." [13]

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. *This credit union tax expenditure is neither focused nor contained; it 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.*

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. 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.

The savings bank charter would give 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 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.

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[12] "NCUA Sells Importance of Increased CUSO Authority To Stay Ahead of Losses", *Credit Union Times,* May 4, 2011.

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

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. S. 509 will 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.

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 nonmembers 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.

Against a backdrop where nontraditional 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

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM DEBORAH MATZ

Q.1. *Supplemental Capital*—My staff and I have recently heard from a number of Oregon credit unions about the need to increase capital at credit unions. Many credit unions—like community banks—have seen an influx in deposits recently, and like community banks, face challenges in raising the capital they need to back those deposits and the loans that come from them. For community banks, as you may know, I worked with a number of my colleagues to help put into place the Small Business Lending Fund, so community banks could gain access to the additional capital they need to meet the lending needs of small business. I'm wondering whether we need to similarly consider additional capital for credit unions.

Specifically, as you know, credit unions are only allowed to accumulate capital through retaining earnings year on year (much the same way a *de novo* (newly licensed) bank does in many States, including Oregon). However, this can be a real challenge for credit unions in a low interest rate environment. If, like community banks, they are taking in many new deposits from members and making new loans, they need capital to back those loans and stay within their leverage ratios. Clearly, if they cannot bring in new capital, then we could potentially face safety and soundness problems.

What can you share with the Committee, at this preliminary stage, about the need for capital in our credit union sector and what role can supplemental capital, carefully constructed, play in ensuring greater safety and soundness at credit unions?

A.1. This is a timely question that I appreciate having the opportunity to address. I have previously encouraged Congress to create a new opportunity for well-capitalized, qualifying credit unions, as determined by the National Credit Union Administration, to issue alternative forms of capital to supplement their retained earnings. This change would allow credit unions to grow stronger especially in difficult economic times and, in turn, lower the risk to the National Credit Union Share Insurance Fund, increasing safety and soundness for the credit union industry.

As you point out in your question, some financially healthy, well-capitalized credit unions that offer desirable products and services are discouraged from marketing them too vigorously out of concern that attracting share deposits from new and existing members will inflate the credit union's asset base, thus diluting its net worth for purposes of prompt corrective action. In effect, the reward for their success in attracting new shares is the risk of a demotion to a lower net worth category if accepting those shares drives down the credit union's net worth ratio.

I believe two legislative remedies would help reverse the disincentive to accept new share deposits—one that addresses the total assets denominator of the net worth ratio, and a second that addresses the retained earnings numerator.

With respect to the denominator, I have encouraged Congress to consider allowing qualifying credit unions to exclude from the "total assets" denominator those assets that have a zero risk-weighting, exposing the credit union to virtually no risk of loss. An example of such "no-risk" assets is short-term Treasury securities.

To qualify for exclusion of no-risk assets from its denominator, I have proposed that a credit union should be required to meet at least two criteria:

1. Maintain a minimum net worth classification, as determined by the NCUA Board, calculated before excluding no-risk assets; and
2. Show that share growth is the cause of its declining net worth ratio, *i.e.,* that the decline is not due to poor management or material unsafe or unsound practices.

Permitting the total assets denominator to exclude no-risk assets would moderate the growth of assets due to the inflow of new shares, while still imposing prompt corrective action that is appropriate to the circumstances.

With respect to the numerator of the net worth ratio, I would encourage Congress to consider authorizing qualifying credit unions, as determined by the NCUA Board, to issue alternative forms of capital to supplement their retained earnings. To ensure the proper authority, alternative forms of capital would be subject to necessary regulations addressing safety and soundness criteria, investor protections, and any impact on the cooperative credit union governance model.

Current law already permits low-income designated credit unions to offer uninsured secondary capital accounts to nonmembers (*e.g.,* 12 USC 1757(6) and 12 CFR 701.34). Modifying the Federal Credit Union Act to permit qualifying credit unions to offer uninsured alternative capital instruments subject to regulatory restrictions, and expanding the law's definition of "net worth" to include those instruments, would allow well-managed credit unions to better manage net worth levels under varying economic conditions. Together, these legislative remedies would go a long way toward removing an obstacle to accepting new shares, thereby enhancing consumers' access to the benefits of credit union service.

Q.2. *Servicing Rights, Foreclosure, and Member/Customer Relationship*—I've heard from my Oregon credit unions about the importance of being able to securitize loans while retaining the servicing rights, which is where the member relationship is important. In that servicing relationship, credit unions—and community banks—who hold servicing rights must have seen some foreclosures and other problems. Can you share any insight on the experience of credit unions and community banks that do hold servicing rights in working out problematic loans? In your experience, are credit unions and community banks more willing to follow basic practices like having a single point of contact, stopping the dual track of modification and foreclosure, and utilizing third-party review for modification? Anything you can share will be enlightening as we go through an important national debate about what can be done now to fix the terrible foreclosure crisis harming our families and dragging our economy down.

A.2. Because NCVA's regulatory oversight does not extend to community banks, I will focus on the experience of credit unions.

In late 2010, NCUA conducted a sweep review of the largest credit union residential real estate loan servicers. The focus was foreclosure procedures and practices that could be detrimental to credit union members. As a result of this sweep review, we reached the overall conclusion that the issues reported in non- credit union mortgage servicers were not prevalent in credit unions.

Additionally, NCVA adjusted our examination procedures in 2011 to require the formal review of credit union loan modification and foreclosure procedures during all examinations in 2011. To date, NCVA has identified only isolated exceptions or issues raised during the servicing reviews.

While NCVA does not consider this a system-wide concern for credit unions at this time, the ongoing discussions between bank regulators, State attorneys general, and the largest servicers have the potential to set new standards for mortgage servicing. Any agreement would likely create a new set of best practices for all servicers, including credit unions, to follow.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM BILL CHENEY

Q.1. *Servicing Rights, Foreclosure, and Member/Customer Relationship*—I've heard from my Oregon credit unions about the importance of being able to securitize loans while retaining the servicing rights, which is where the member relationship is important. In that servicing relationship, credit unions—and community banks—who hold servicing rights must have seen some foreclosures and other problems. Can you share any insight on the experience of credit unions and community banks that do hold servicing rights in working out problematic loans? In your experience, are credit unions and community banks more willing to follow basic practices like having a single point of contact, stopping the dual track of modification and foreclosure, and utilizing third-party review for modification? Anything you can share will be enlightening as we go through an important national debate about what can be done now to fix the terrible foreclosure crisis harming our families and dragging our economy down.

A.1. No response provided.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM NOAH WILCOX

Q.1. *Servicing Rights, Foreclosure, and Member/Customer Relationship*—I've heard from my Oregon credit unions about the importance of being able to securitize loans while retaining the servicing rights, which is where the member relationship is important. In that servicing relationship, credit unions—and community banks—who hold servicing rights must have seen some foreclosures and other problems. Can you share any insight on the experience of credit unions and community banks that do hold servicing rights in working out problematic loans? In your experience, are credit unions and community banks more willing to follow basic practices like having a single point of contact, stopping the dual track of modification and foreclosure, and utilizing third-party review for modification? Anything you can share will be enlightening as we go through an important national debate about what can be done now to fix the terrible foreclosure crisis harming our families and dragging our economy down.

A.1. No response provided.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM MICHAEL LUSSIER

Q.1. *Servicing Rights, Foreclosure, and Member/Customer Relationship*—I've heard from my Oregon credit unions about the importance of being able to securitize loans while retaining the servicing rights, which is where the member relationship is important. In that servicing relationship, credit unions—and community banks—who hold servicing rights must have seen some foreclosures and other problems. Can you share any insight on the experience of credit unions and community banks that do hold servicing rights in working out problematic loans? In your experience, are credit unions and community banks more willing to follow basic practices like having a single point of contact, stopping the dual track of modification and foreclosure, and utilizing third-party review for modification? Anything you can share will be enlightening as we go through an important national debate about what can be done now to fix the terrible foreclosure crisis harming our families and dragging our economy down.

A.1. No response provided.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM STEPHEN P. WILSON

Q.1. *Servicing Rights, Foreclosure, and Member/Customer Relationship*—I've heard from my Oregon credit unions about the importance of being able to securitize loans while retaining the servicing rights, which is where the member relationship is important. In that servicing relationship, credit unions—and community banks—who hold servicing rights must have seen some foreclosures and other problems. Can you share any insight on the experience of credit unions and community banks that do hold servicing rights in working out problematic loans? In your experience, are credit unions and community banks more willing to follow basic practices like having a single point of contact, stopping the dual track of modification and foreclosure, and utilizing third-party review for modification? Anything you can share will be enlightening as we go through an important national debate about what can be done now to fix the terrible foreclosure crisis harming our families and dragging our economy down.

A.1. No response provided.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER SUBMITTED BY PAUL HAZEN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COOPERATIVE BUSINESS ASSOCIATION

NCBA
National Cooperative Business Association

June 15, 2011

Honorable Tim Johnson
United States Senate
136 Hart Senate Office Building
Washington, D.C. 20510

Honorable Richard Shelby
United States Senate
304 Russell Senate Office Building
Washington, D.C. 20510

Dear Senators Johnson and Shelby:

As President and CEO of the National Cooperative Business Association, I encourage you to support legislation to permit credit unions to meet fully the credit needs of America's small businesses by increasing the statutory credit union member business lending cap. Further, I ask that you promote this view during the upcoming hearing on "Credit Unions: Member Business Lending" scheduled before the US Senate Banking, Housing and Urban Affairs Committee, Thursday, June 16, 2011.

In an effort to promote economic recovery and job creation, NCBA strongly urges Congress to increase the credit union member business lending cap. Easing business lending limits on credit unions will be at no cost to the American taxpayer and will provide much needed credit into our economy. Now more than ever, small businesses need access to capital to grow and to create jobs.

For over 100 years, credit unions have been serving credit needs of their small business-owning members. Many credit unions are quickly approaching the business lending cap set in 1998 for credit unions while others choose not to engage in business lending because of the cap.

On behalf of over 29,000 US cooperative businesses, the National Cooperative Business Association thanks you for your consideration with this important issue. We look forward to assisting you in efforts to provide economic opportunities for America's small businesses.

Sincerely,

Paul Hazen

Paul Hazen, President and CEO

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