



Testimony of

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President/CEO of the National Association of Federal Credit Unions

regarding

“H.R. 1697: the Communities First Act”

Before a joint hearing of the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit and

Subcommittee on Capital Markets and Government Sponsored Enterprises

November 16, 2011

Introduction

Good afternoon, Chairman Shelley Moore Capito, Chairman Scott Garrett, Ranking Members Carolyn Maloney and Maxine Waters and members of the Subcommittees. My name is Fred Becker. I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU), where I have served as the President and CEO since 2000. I appreciate the opportunity to share our views on H.R. 1697 and the need for regulatory relief for all community based financial institutions.

NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion on how relieving regulatory burden on our nation's financial depository institutions can help them better serve their communities and, most importantly, help grow our economy as it continues to strive to recover from the Great Recession.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans, including making business loans. Established by an Act of Congress in 1934, the federal credit union system was created—and has been widely recognized—as a way to promote thrift and to make financial services available to all Americans, including small businesses, who 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.

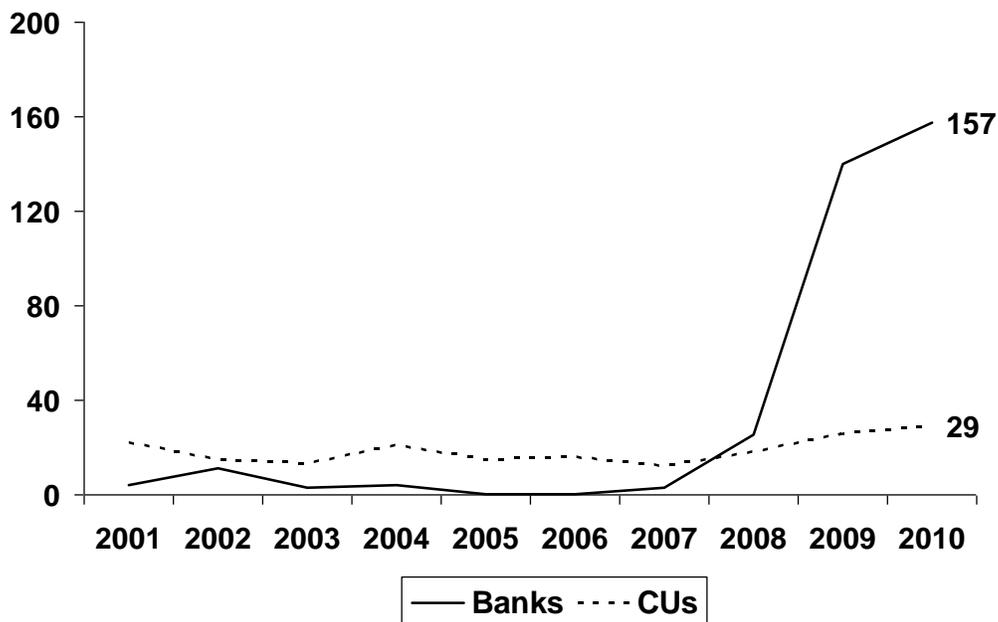
Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 U.S.C. §1752(1)). While more than 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into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

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

The nation’s approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members—while banks strive to make a profit for their shareholders while also serving their customers. 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. Federal credit union directors also generally serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

While credit unions did not create the financial crisis, credit unions have nevertheless been adversely impacted by the ongoing economic upheaval and ensuing legislation and regulation. However, as indicated in the chart below, credit union failures have been relatively minimal as compared to other financial depository institutions.

Failures



Source: NCUA Annual Reports, FDIC Quarterly Banking Profile

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Today, credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation among financial depository institutions has progressed with the resulting de-personalization in the delivery of financial services by some large banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. While many large banks have increased

their fees and curtailed customer service as of late, credit unions have continued to provide their members with high quality personal service at the lowest possible cost. This has been evidenced most recently as thousands of Americans turned to local credit unions after several large national banks proposed new fee increases.

Credit Unions Need Regulatory Relief in a Number of Areas

NAFCU recognizes the leadership and effort of Representative Blaine Luetkemeyer to bring relief to community based institutions. Credit unions are among the most heavily regulated of all financial institutions, with a number of statutory limits on their ability and powers that have been in place since the last century. Passage of new financial reforms in recent years has only increased the regulatory and compliance burdens on credit unions. Unfortunately, every additional dollar spent on compliance, whether stemming from a new law or outdated regulation, is a dollar that could have been used to reduce cost or provide additional services to a member. With that in mind, there are a number of areas where NAFCU would like to see relief—relief that would help credit unions enhance their service to their 93 million members. I have outlined some of these areas below.

Arbitrary Member Business Lending Restrictions

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it placed restrictions on credit union member business lending. Credit unions had existed for nearly 90 years and operated in a safe and sound manner without such statutory restrictions. First, 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.

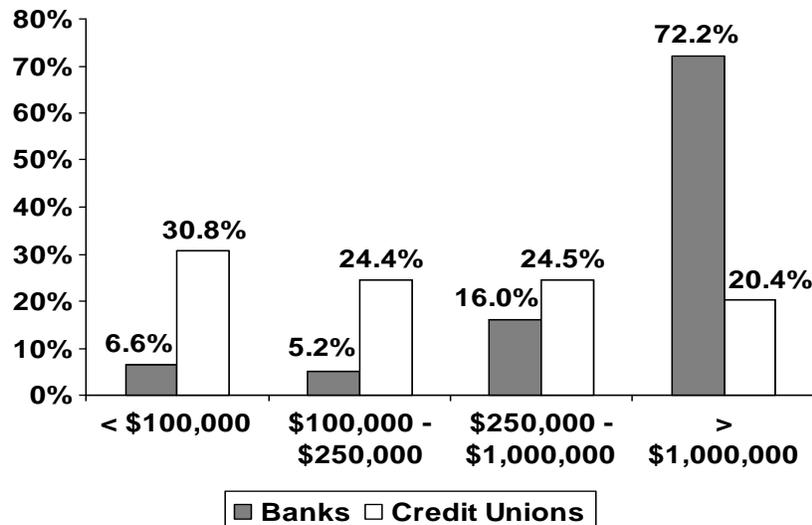
Second, Congress established, by definition, that a business loan of \$50,000 and above is a member business loan that counts toward the statutory limitation. This number was not indexed and has not been adjusted for inflation in the more than 13 years since enactment, eroding the *de minimis* level. While many vehicle loans or small lines of credit were initially exempt from the cap in 1998, many of those that meet the needs of small businesses today are now included in the statutory limitation. To put this in perspective, what cost \$50,000 in 1998 costs \$69,500 today, based on the August 2011 consumer price index data.

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” finding that: “credit union’s business lending ... (had) no effect on the viability and profitability of other insured depository institutions.” (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that “relaxation of membership restrictions in the Act should serve to further increase member business lending...” (p. 41).

As the chart on the next page demonstrates, while the majority of bank business lending focuses on making larger (\$1+ million) business loans, the vast majority of credit union loans are smaller loans.



Business Loan Portfolio Distribution



Source: FDIC "Statistics on Banking", NAFCU *Economic & CU Issues Monitor* survey

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While the 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, it did note that in certain cases, credit union business lending could be an important source of competition for banks. Nevertheless, today credit unions market share is approximately 5% of all small business loans. As of December 31, 2010, credit unions had approximately 165,800 outstanding member business loans, totaling just over \$33 billion.

A more recent 2011 study, commissioned by the Small Business Administration's Office of Advocacy, found that bank business lending continues to be largely unaffected by changes in credit unions' business lending and that credit unions' business lending can actually help offset declines in bank business lending and satisfy lending demand during a recession (James A.

Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA's findings in this regard are reflected by the fact that lending by banks as a percentage of their assets contracted during the 2007 – 2010 financial crisis, while credit union lending, as a percentage of their assets, increased. The SBA's finding, therefore, demonstrates the necessity to lift the MBL cap to meet credit union members' demand, as well as demonstrates credit unions' continued efforts to meet the capital needs of their members during the most difficult financial environment since the Great Depression.

In April of 2011, Representatives Ed Royce and Carolyn McCarthy introduced the *Small Business Lending Enhancement Act* (H.R. 1418), which would raise the arbitrary credit union member business lending cap to 27.5 % of total assets, up from 12.25%, and help stimulate the nation's struggling economy by increasing access to credit for small business owners. This important legislation has over 100 bipartisan co-sponsors. Identical bipartisan legislation (S. 509) has been introduced in the Senate.

Industry estimates indicate that enacting the *Small Business Lending Enhancement Act* would help spur over \$13 billion in business lending and help small businesses create over 140,000 new jobs in the first year alone. This is a well thought out solution, supported by the Obama Administration and the National Credit Union Administration (NCUA), that includes important provisions to ensure that safety and soundness concerns are addressed. Enacting this legislation will not only aid credit unions, but also the small businesses that they serve.

Limitations on Ability to Access Capital

Credit unions are restricted in their ability to raise capital and are subject to capital benchmarks under a regulatory prompt corrective action (PCA) regime. Furthermore, credit union capital under PCA does not fully account for risk. Congress should modernize capital requirements for credit unions, including allowing access to supplemental capital. To preserve mutuality, NAFCU recommends that supplemental capital for federally insured credit unions come from members, to include sponsor organizations and select employee groups. This supplemental capital should not be federally insured, and it must be subordinate to other claims against an insured credit union and the National Credit Union Share Insurance Fund.

Furthermore, very few new credit unions are being started today. One reason is that a new credit union with more than \$10 million in capital when it is chartered must comply with PCA requirements. A suggested fix would be to modify Section 216(o)(4) of the *Federal Credit Union Act* to give new credit unions some relief from PCA. We suggest that a “new credit union” be defined as one that: “(A) has been in operation for less than 10 years; *or* (B) has not more than \$10,000,000 in total assets.”

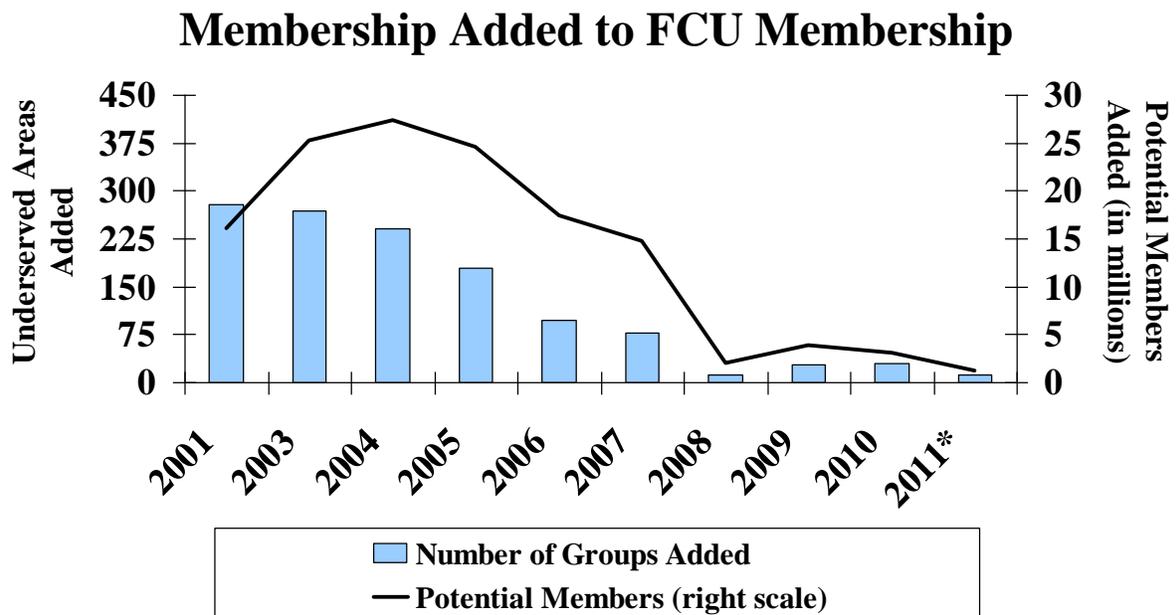
Underserved Areas

Credit unions play an important role in helping those that other financial institutions have turned their backs on and left behind. NAFCU supports making a necessary clarification to the 1998 *Credit Union Membership Access Act* (CUMAA) that all credit unions are able to add underserved areas to their fields of membership, regardless of charter type. In 2005, the American Bankers Association brought litigation against NCUA arguing that under the CUMAA (American Bankers Association et al. v. NCUA, No. 2:05-cv-000904 (D. Utah, filed Nov. 1,

2006)), in the case of federally chartered federal credit unions, only multiple-common-bond credit unions could add underserved areas to their fields of membership (FOM). In response to that lawsuit, NCUA limited expansion of underserved areas to multiple-group FOM federal credit unions in June 2006, substantially curtailing expansion into underserved areas (see chart below). As a result, in 2011, NAFCU is projecting that credit unions will add 12 underserved areas, representing 1.2 million people. By contrast, during 2001, credit unions added 279 underserved areas with 16 million potential members. As is, therefore, readily apparent, the 2006 limitation of underserved area expansions to multiple common bond credit unions has also had a significant impact on FCU loan growth in underserved areas (see chart on next page).



Underserved Areas Added

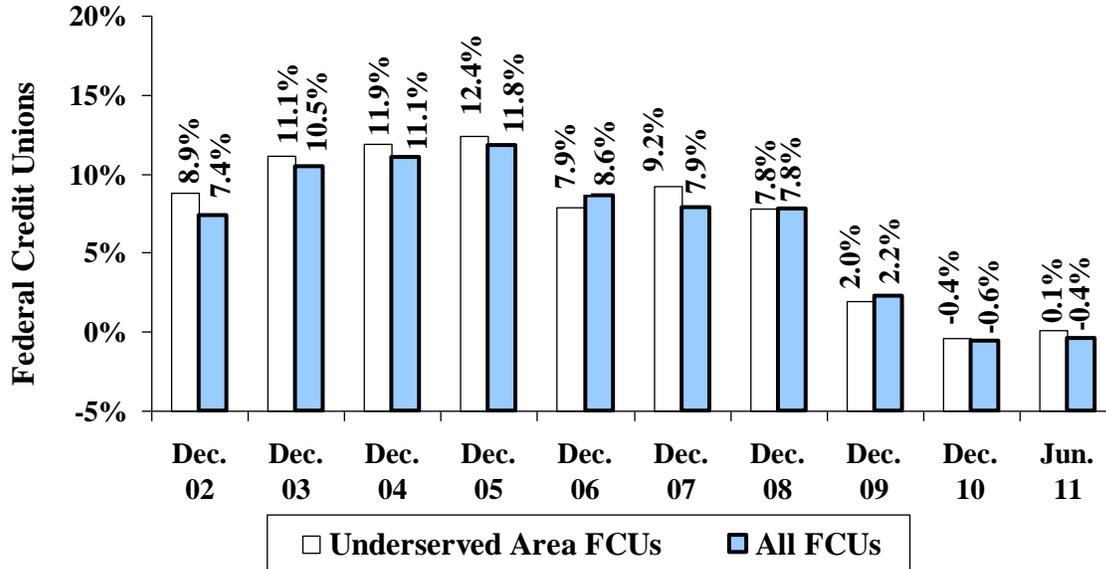


**Projected Figure*

Source: NCUA



Underserved Area Loan Growth



Note: The numbers are based on same-store sales.

Source: NCUA

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Community Charter Conversions Involving Employee Group Credit Unions

Under current law, federally chartered federal credit unions that convert to a community FOM from a multiple group FOM may no longer add individuals from their select employee groups (SEGs) to their membership where the member does not work or reside within the community. This results in disparaging outcomes. For example, in 2011, Finance Center Federal Credit Union in Indianapolis, Indiana, converted to a community credit union. At that time, Finance Center Federal Credit Union served, as a select employee group (SEG), a military base in Europe. As a result of the conversion to a community charter, Finance Center Federal Credit Union was no longer able to add to its membership those members of the military stationed at the

base who wished to join the credit union – a result that neither the credit union nor the base desired.

NAFCU strongly supports giving the NCUA the authority to allow credit unions to continue to add members from their SEGs after a credit union converts to a community charter. This change would ensure that groups within the credit union’s existing membership at the time of conversion are not discriminated against and are able to join the credit union if they wish, even though they reside or work outside the new community charter’s geographic boundaries. This continuity of services is especially important for credit union members as the country struggles to regain sound economic footing.

Authority of NCUA to establish longer maturities for certain credit union loans

NAFCU supports providing NCUA with the flexibility to provide for loan terms exceeding 15 years, for certain types of loans. As part of regulatory relief efforts in the 109th Congress, the NCUA was allowed to increase the 12-year limit on non-real-estate-secured loans to 15 years. NAFCU, however, believes that greater flexibility is warranted for certain products, such as student loans.

Credit union governance

The FCUA contains many antiquated “governance” provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and

policies of a federal credit union. For example, federal credit unions are not allowed to expel disruptive or threatening members without a two-thirds vote of the membership. NAFCU supports giving federal credit union boards this necessary flexibility.

Providing NCUA with greater flexibility to respond to market conditions

NAFCU supports giving the NCUA greater flexibility to adjust interest rates relative to market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans. We believe that the NCUA should have greater flexibility regarding the tests that must be met to modify those limits under certain market conditions.

Voluntary mergers involving multiple common bond credit unions

Current law imposes a numerical limitation of 3,000 on the size of a group that can go forward with a federal credit union merger before considering spinning off the group and requiring it to form a separate credit union. There is no sound reason for this restriction; NAFCU believes the 3,000 limit is arbitrary and should be removed.

Interest on Lawyers Trust Accounts (IOLTAs)

Last year Congress passed legislation to clarify and expand FDIC coverage for lawyer's trust accounts held at banks. Similar action should be taken for such accounts held at federally insured credit unions.

Member business loan exclusion for loans in underserved areas

NAFCU supports excluding member business loans made in underserved areas from the credit union member business lending cap. We feel that this proposal reflects an understanding that the credit union member business lending cap is often restrictive, hindering credit unions from promoting economic growth in underserved areas. While NAFCU also supports an overall modification in the member business lending cap to better facilitate economic growth in all the communities that credit unions serve, we also recognize that there continues to be an urgent need to address this matter with regard to underserved areas.

H.R. 1697, the *Communities First Act*

While many of the provisions in the *Communities First Act* provide regulatory and tax relief to community banks, we would like to make special note of Section 107, which includes language supported by NAFCU, and many in the financial services community that would improve the unrealistic veto threshold needed for the Financial Stability Oversight Council to review new rules issued by the Consumer Financial Protection Bureau. We are pleased that such a provision

has already passed the House in the form of H.R. 1315, the *Consumer Financial Protection Safety and Soundness Improvement Act of 2011*.

We would also note Section 201 of the bill, which would amend the Dodd-Frank Act to provide that loans held in portfolio by banks under \$10 billion in assets are excluded from escrow requirements. NAFCU believes this is a good idea in principle; however, we believe such an exemption should be made for all credit unions. We are disappointed that the legislation, in this section and others, continues to advance the arbitrary \$10 billion dividing line threshold for many provisions. We see that as a major flaw in the legislation. It should be noted, in the only vote in the 111th Congress that the full Committee took where it had a choice to replace the arbitrary \$10 billion number found throughout the Dodd-Frank Act, the Committee choose \$50 billion by an overwhelming bipartisan margin of 52-17 (Full Committee Record Vote FC-99).

As our great nation continues to strive to recover from the Great Recession, NAFCU believes that it is imperative that every effort be made to strengthen the access and improve the availability of low cost financial services to all Americans. In keeping with that spirit and intent, we believe that the *Communities First Act* can be strengthened by adding the provisions to provide relief to credit unions as outlined earlier in my testimony. Such an approach would create a comprehensive reform bill that could create more jobs, help communities, garner bipartisan support, and help the economy further its recovery.

While the banking industry consistently argues that credit unions should not have increased powers and authorities to better serve their members, NAFCU has never previously opposed enhanced authorities for banks to better serve their customers. In particular, we would note that H.R. 1697 includes provisions to strengthen the Subchapter S tax option and other tax breaks for banks. A large number of banks do not pay corporate federal income tax because of their Subchapter S status. In fact, there are approximately 2,358 Subchapter S banks that avoid federal corporate income taxes today. One estimated value of the Subchapter S federal tax break for banks is \$2.05 billion for 2010, *which is significantly greater* than the estimated value of the entire credit union tax expenditure (\$1.27 billion) for FY 2010 as included in the President's FY 2012 budget. Enacting H.R. 1697 will likely increase the total value of the Subchapter S tax break.

Conclusion

Financial depository institutions and, in particular, credit unions are in need of regulatory relief. H.R. 1697, the *Communities First Act*, would be greatly strengthened by adding credit union relief provisions and moving the larger package, creating a win-win for community banks and credit unions and, most importantly, the American economy.

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