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**WRITTEN STATEMENT
OF
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ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION (CUNA)
BEFORE THE
HOUSE SMALL BUSINESS COMMITTEE'S
SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
ROUNDTABLE ON REGULATORY ISSUES**

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REMARKS OF THE CREDIT UNION NATIONAL ASSOCIATION

**TO THE SUBCOMMITTEE ON REGULATORY REFORM AND OVERSIGHT
OF THE HOUSE COMMITTEE ON SMALL BUSINESS
ROUNDTABLE ON REGULATORY ISSUES**

I am Michael Hearne, participating today in the House Small Business Committee's Subcommittee on Regulatory Reform and Oversight Roundtable on Regulatory Issues on behalf of the Credit Union National Association (CUNA), the largest credit union advocacy organization, representing over 90% of our nation's approximately 9,400 state and federal credit unions and their 85 million members. Currently, President and CEO of LaFayette FCU, Kensington, Maryland, which includes the employees of the SBA in its field of membership.

Just as brief background, I spent seven years in the Small Business Administration's (SBA) Office of the Chief Financial Officer, ultimately directing the Financial Policy Group. I supervised the agency's Financial Improvement Plan (FIP), which resulted in the development of the current financial data structure and all credit program subsidy models. I am very familiar with the SBA accounting, budget reporting, and Management Information Systems. Since leaving the SBA, I have been an independent consultant working with numerous SBA lenders to analyze their loan portfolios and have provided SBA loan sale bidders with historic performance analyses to aid in developing their bids. I have also worked as a consultant to CUNA to help develop a business lending program that would assist well managed credit unions to make member business loans, including SBA 7a borrowings.

CUNA applauds the Chair for holding this roundtable to address the regulatory burdens that impact small business loan activity of financial institutions, and in particular, the regulatory burdens that impact credit unions' ability to better serve their 85 million members.

HELPING SMALL BUSINESS

Title II, Section 203 of the *Credit Union Membership Access Act of 1998* (CUMAA) established limits on credit union member business loan (MBL) activity. There were no statutory limits on credit union member business lending prior to 1998. The CUMAA-imposed limits are expressed as a 1.75 multiple of net worth, but only net worth up to the amount required to be classified as well capitalized (i.e., 7%) can be counted. Hence the limit is $(1.75 \times .07)$ or 12.25% of assets for practically all federally insured credit unions.

NEED FOR REFORM OF CREDIT UNION MBL LIMITS

Small businesses are the engine of economic growth – accounting for about one-half of private non-farm economic activity in the U.S. annually. Their ability to access capital is paramount. But this access is seriously constrained by the double-whammy of banking industry consolidation and the CUMAA-imposed limitations on credit union MBLs. Research published in 2004 by the SBA reveals that small businesses receive less credit

on average in regions with a large share of deposits held by the largest banks. Federal Deposit Insurance Corporation statistics show that the largest 100 banking institutions now control nearly two-thirds of banking industry assets nationally. In 1992 the largest 100 banking institutions held just 45% of banking industry assets. Thus, CUMAA severely restricts small business access to credit outside the banking industry at a time when small firms are finding increasing difficulty in accessing credit within the banking industry.

Basic problems with the current MBL limits are:

THE LIMITS ARE ARBITRARY AND UNNECESSARILY RESTRICTIVE.

Insured commercial banks have no comparable business lending portfolio concentration limitations. Other financial institutions, savings and loans, for example, have portfolio concentration limitations, but those limitations are substantially less restrictive than the limits placed on credit unions in CUMAA.

THE 12.25% LIMIT DISCOURAGES ENTRY INTO THE MBL BUSINESS. Even though very few credit unions are approaching the 12.25% ceiling, the very existence of that ceiling discourages credit unions from entering the field of member business lending. Credit unions must meet strict regulatory requirements before implementing an MBL program, including the addition of experienced staff. Many are concerned that the costs of meeting these requirements cannot be recovered with a limit of only 12.25% of assets. For example, in today's market, a typical experienced mid-level commercial loan officer would receive total compensation of approximately \$100,000. The substantial costs associated with hiring an experienced lender, combined with funding costs and overhead and startup costs (e.g., data processing systems, furniture and equipment, printing, postage, telephone, occupancy, credit reports and other operating expenses) make member business lending a very unpractical option at most credit unions given the current 12.25% limitation. In fact, assuming credit unions could carry salary expense of 2% of portfolio, 76% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the current 12.25% of asset maximum. Alternatively, assuming credit unions could carry salary expense of 4% of portfolio, 63% of CUs couldn't afford to be active member business lenders even if they had portfolios that were equal in size to the current 12.25% of asset maximum.

THE LIMITS ARE NOT BASED ON SAFETY AND SOUNDNESS CONSIDERATIONS. There is no safety and soundness reason that net worth above 7% cannot also support business lending. If all net worth could be counted, the actual limit would average between 18% and 19% of total assets rather than 12.25% of total assets.

THE MBL DEFINITIONS CREATE DISINCENTIVES THAT HURT SMALL BUSINESSES. The current \$50,000 threshold for defining an MBL is too low and creates a disincentive for credit unions to make loans to smaller businesses because they have to set up a formal member business lending program in compliance with all the requirements of Section 723 of the NCUA's regulations. Compliance with these requirements is very expensive and not cost effective for making loans of such a small amount. Thus, permitting the threshold to rise to \$100,000 would open up a significant

source of credit to small businesses. These “small” business purpose loans are so small as to be unattractive to many larger lenders. Simply adjusting the \$50,000 threshold for inflation would result in an approximate 33% increase in the threshold to over \$65,000. The \$50,000 threshold was initially established in 1993 and hasn’t been adjusted since that time. In fact, the NCUA was poised to adopt a \$100,000 threshold by regulation in 1998 until CUMMA incorporated the \$50,000 regulatory definition into statute that year.

Some bankers call credit union member business lending “mission creep.” This is simply a preposterous fiction. Credit union member business lending is not new. Since their inception, credit unions have offered business-related loans to their members. Moreover, credit union member business lending shows a record of safety. According to a U.S. Treasury Department study, credit union business lending is more regulated than commercial lending at other financial institutions. In addition, the Treasury found that:

“...member business loans are generally less risky than commercial loans made by banks and thrifts because they generally require the personal guarantee of the borrower and the loans generally must be fully collateralized. Ongoing delinquencies – for credit unions, loans more than 60 days past due, and for banks and thrifts, loans more than 90 days past due – are lower for credit unions than for banks and thrifts. Credit unions’ mid-year 2000 loan charge-off rate of 0.03 percent was much lower than that for either commercial banks (0.60 percent) or savings institutions (0.58 percent).”

Not surprisingly, the Treasury also concluded that member business lending “does not pose material risk to the” National Credit Union Share Insurance Fund.

Updated statistics from full-year 2000 through 2003 indicate that the favorable relative performance of MBLs reported in the Treasury study has continued in recent years. Credit union MBL net chargeoffs have averaged just 0.08% over the four-year period since the Treasury study, while the comparable average net chargeoff rate at commercial banks was 1.28% and at savings institutions was 1.11%. MBLs have even lower loss rates than other types of credit union lending, which themselves have relatively low loss experience.

Credit union member business lending represents a small fraction of total commercial loan activity in the United States. At mid-year 2004, the dollar amount of MBLs was less than one-half of one percent of the total commercial loans held by U.S. depositories. Credit union MBLs represent just 3.1% of the total of credit union loans outstanding, and only 17.9% of U.S. credit unions offer MBLs. According to credit union call report data collected by the National Credit Union Administration, the median size of credit union MBLs granted in the first six months of 2004 was \$140,641.

An almost two-thirds increase in credit union MBL limits (from 12.25% to 20% of assets, equivalent to the business lending limit for savings institutions) would not cause these numbers to change dramatically.

Raising the current MBL limits would help small business. As noted earlier, small businesses are the backbone of the nation's economy. The vast majority of employment growth occurs at small businesses. And small businesses account for roughly half of private non-farm gross domestic product in the U.S. each year.

Small businesses are in need of loans of all sizes, including those of less than \$100,000, which many have said banks are less willing to make.

Moreover, large banks tend to devote a smaller portion of their assets to loans to small businesses. The continuing consolidation of the banking industry is leaving fewer smaller banks in many markets. In fact, the largest 100 banking institutions accounted for 42% of banking industry assets in 1992. By year-end 2003, the largest 100 banking institutions accounted for 65% of banking industry assets – a 23-percentage point increase in market share in just eleven years.

This trend and its implications for small business credit availability are detailed in a recently released SBA paper. The findings reveal “credit access has been significantly reduced by banking consolidation...we believe this suggests that small businesses, especially those to which relationship lending is important, have a lower likelihood of using banks as a source of credit.”

In reforming credit union MBL limits Congress will help to ensure a greater number of available sources of credit to small business. This will make it easier for small businesses to secure credit at lower prices, in turn making it easier for them to survive and thrive.

OTHER CONCERNS WITH THE REGULATION OF MEMBER BUSINESS LOANS

Credit unions are concerned that the regulatory limits on member business lending for construction projects are too restrictive and severely curtail the ability of even large credit unions to support more than one builder in high cost areas, such as Washington, DC, even though the need for such lending is great, particularly in low income areas. These can be productive loans for the credit unions as well as their business members if done correctly but the current limits stymie increased credit union involvement. Also the loan to value ratios are restrictive in many cases.

Also, unless a credit union has 9% net worth, and many do, it is required to obtain the person guarantee of a business loan member/borrower. A credit union that has 9% net worth and is a “RegFlex” credit union under NCUA's rules is able to avoid this requirement but credit unions with lower net worth ratios, which are still well-capitalized should be able to make member business loans without securing the member's personal guarantee.

The maturity limits are also restrictive and in effect, curtail member business lending needlessly. The National Credit Union Administration should have the authority to permit longer terms on member business loans.

In general, credit unions run the risk of being regulated right out of sound member business lending programs. By severely restricting the amounts credit unions can lend, the terms, the structure, etc. federal policy forces credit unions to assume the role of lender of last resort, after the borrower has been turned down by the banks.

CREDIT UNION CONCERNS REGARDING SBA'S 7(a) LOAN PROGRAM

Credit unions and CUNA applauds the SBA for its bold steps to permit credit unions greater access to the agency's lending program, particularly the 7a program. In fact, as recently as last month, CUNA honored SBA Administrator Hector Barreto at our Governmental Affairs Conference in Washington, DC, with almost 4,000 credit union officials looking on.

Our concerns about the program relate mostly to the issue of whether the agency has sufficient funding for the 7a program and other vital programs from the SBA. Going forward, we urge Congress to reconsider the importance of the 7a program in helping to support small businesses in this country and improve the funding process for this very significant program.

Meanwhile, we do encourage the agency to consider streamlining the approval process and to take further action to insure the regional offices are current on all SBA policies, including ones on credit unions' access to SBA lending.

CONCLUSION

In summary, Mr. Chairman, CUNA is grateful to the Subcommittee for holding this roundtable discussion on regulatory issues that impact small business lending activities. CUNA looks forward to working with the subcommittee to further act on these very important issues. Credit unions would benefit greatly from reducing unnecessary and costly regulatory burdens; and more importantly, so too would American consumers benefit from the additional savings that credit unions would pass along to their 85 million members.