

The Need for Supplemental Capital

Did You Know?

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

Our Ask:

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

What are the Policy Implications?

- The recent financial crisis led to a substantial drop in the average credit union capital ratio – from 11.4% at the end of 2007 to 10.1% at the end of 2011. At the beginning of the downturn, 90% of credit unions had net worth ratios of 9% or greater compared with approximately 75% at the end of 2011.
- While the credit union movement as a whole remains very well capitalized, a number of credit unions are close to or past the prompt corrective action (PCA) triggers as a result of the financial crisis. These credit unions will need to raise capital at a time when the outlook for credit union net income – the source of retained earnings – is not particularly strong.
- Long term influences on credit union net income are not promising. Net interest income, essentially the difference between what credit unions earn in interest on loans and investments and what they pay in interest and dividends on savings has been on a long-term downtrend caused by intense competition on both sides of the balance sheet. This pressure is unlikely to abate significantly going forward. In addition, interchange income, an important source of non-interest revenue, is under political pressure and is likely to diminish.

What are the Implications for Credit Unions?

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

H.R. 3993- Capital Access for Small Businesses and Jobs Act

(As of 8.1.12)

Lead Sponsors: Rep. Peter King (R-NY)

Co-Sponsors: 42 including Rep. Sherman (D-CA)

Last Action: Referred to House Subcommittee on Financial Institutions and Consumer Credit