



Credit Union National Association

cuna.org

PO Box 431 | Madison, WI 53701-0431 | 5710 Mineral Point Road | Madison, WI 53705-4454 | PHONE: 608-231-4000

November 17, 2005

The Honorable William M. Thomas
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Thomas:

On behalf of the Credit Union National Association, our affiliated state associations and leagues, and America's 87 million credit union members, I appreciate the opportunity to submit this letter as a means of clarifying several issues raised in your Committee's November 3, 2005 hearing to review the federal tax-exempt status of credit unions. Please incorporate this letter into the hearing record.

In this letter, I will also address several incorrect and misleading statements about credit unions and our mission made by witnesses from the commercial banking industry. We appreciate your review of this letter and please do not hesitate to contact me or my staff if you have further questions or need clarification on any of the issues raised during the hearing.

I. TRANSPARENCY

Assertion: Credit unions are not providing adequate financial information to their members.

CUNA response: Credit unions are required by law to conduct an annual audit, and credit unions with \$500 million or more in assets must have an audit conducted by an independent, state-licensed auditing firm using generally accepted auditing standards, similar to the requirement applicable to banks (12 USC §1782(a)(6)). A federal credit union is required to publicly post its financial statements monthly at its office, and the financial report on the condition of the credit union is presented at the annual membership meeting. This is more disclosure than required by closely held community banks.

Similar to banks, credit unions are required to file a call report (Form 5300) quarterly with their regulators, which provides detailed information about the financial condition and activities of the credit union and includes aggregate information about employee compensation and benefits. The call reports for all federally insured credit unions are publicly available on the National Credit Union Administration's website.



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Assertion: The fact that all credit unions do not file Form 990 with the Internal Revenue Service raises concerns.

CUNA response: As highly regulated depository institutions, credit unions are quite different from other non-profit, tax-exempt organizations in the United States. As discussed above, credit unions are subject to detailed financial reporting and oversight by examiners trained to make sure that credit unions are accurately reporting their financial condition and use of their funds. We question why *any* credit union should be subject to IRS Form 990 reporting.

In fact, at the November 3 hearing, we understood the IRS witness to question whether the Form 990 provides information addressing the questions raised by members of the committee. At one time, the IRS relied upon a group 990 form from NCUA on behalf of federal credit unions, and decided years ago that that form was unnecessary. And, as authorized by the Service, 22 states today provide a group 990 on behalf of state chartered credit unions in their state.

The 990 form does contain one line (line 78a) referencing the 990-T filing responsibility. As explained in our testimony on page 8, credit unions have been trying for a number of years to obtain guidance from the IRS on the possible application of the Unrelated Business Income Tax (UBIT) provisions to state chartered credit unions. UBIT is a complicated area, and as depository institutions, credit unions have some unique issues that need to be addressed. CUNA thinks it is unreasonable to expect any credit union to be filing Form 990-T forms until adequate, public guidance is issued.

Assertion: Because of possible concerns raised about some charitable organizations misappropriating funds to pay exorbitant salaries, credit unions should make public the compensation they pay their senior officials.

CUNA response: We think there is an understandable sensitivity of many credit union CEOs about having their salary publicly disclosed. More importantly, we do not consider there to be a parallel between charitable organizations which publicly solicit funds for a stated goal of carrying out charitable activities and credit unions which receive funds from their members for the stated goal of providing them a good return on their deposits and a good rate on their loans.

Volunteer, unpaid credit union boards of directors set the salary and benefits of their CEOs. They do so in a competitive environment, and draw upon surveys, such as those done by CUNA, to determine appropriate compensation packages.

Assertion: Credit unions are not subject to sufficient internal control requirements.

CUNA response: There is no basis for any statement that credit unions lack adequate internal controls, and an effective system of internal controls is a very high priority for each credit union, credit union regulators, the National Credit Union Share Insurance Fund, and private companies that provide credit unions with fidelity bond and other insurance coverage.

A review of the NCUA Examiner Guide shows that continual review and monitoring of internal controls at credit unions is expected by the credit union itself and by its examiner. Obviously, the specific internal control system in place will vary based on the size of the credit union, but the long history of the success of the credit union movement and the soundness of the National Credit Union Share Insurance Fund demonstrate that internal controls are not a problem in the credit union movement.

II. SERVING PEOPLE OF MODEST MEANS

Assertion: Credit unions underperform banks in lending to low and moderate-income and minority borrowers, and banks deny fewer loan applications from underserved populations than credit unions do.

CUNA response: The reality is that credit unions for the past two years have granted a greater proportion of their loans to low- and moderate income (LMI) borrowers than other lenders have, in reviewing Home Mortgage Disclosure Act (HMDA) data. In 2004, credit unions made a greater proportion of combined loans to LMI borrowers (27.6%) than did all other lenders (26.6%). The credit union advantage was even greater, 29% to 25.9%, in purchase loans, an even more important type of lending to help people, including first timers, to buy homes.

We recognize the percent differentials are not dramatic, but there is a good reason why we expect to see greater increases in the near future. Until quite recently, credit unions labored under rules that primarily limited membership to occupational groups large enough to support a credit union's operations. In the 1980s, credit unions were permitted to add smaller employee groups, but significant growth of community based credit unions and permission to expand into underserved areas are a much more recent events. Thus, until very recently, unless one worked for a relatively large employer, one was unlikely to be eligible to join a credit union. Under these rules, credit unions developed into powerful sources of financial services for working Americans. It's no wonder that credit union membership became concentrated in middle and upper middle-income groups.

With the passage of the Credit Union Membership Access Act of 1998 (PL 105-219), adding additional select employee groups, taking on a community charter, or adding underserved areas to the field of membership became more feasible. However, this could not have been expected to lead to an immediate change in the income distribution of credit union members. It takes time for credit unions to reach out to new markets. It also takes time for potential members to learn of and take advantage of what credit unions have to offer.

Bankers and some community groups are misinterpreting the HMDA data if they conclude that banks deny fewer loan applications from underserved populations than credit unions do. Since credit unions actually deny far fewer mortgage loan applications across the board than other lenders, from both lower income and other applicants, the denial disparity ratio is a misleading measure of performance of lending to LMI borrowers. In 2004, 74.1% of applications from LMI applicants were approved by credit unions compared to only 51.1% at other lenders. CUNA will provide the committee with a detailed analysis of HMDA data upon request.

We note with interest that on October 31, 2005 -- in the same week that the banking industry testified to the committee about credit unions' "inadequacies" in serving low-income people -- the banking industry sued NCUA to stop federal community credit unions from adding underserved areas to their charters. As we stated at that time, this shows that the banking industry's only real agenda is to squelch competition from more consumer-friendly institutions.

Assertion: Credit unions should not engage in business lending because it detracts from lending they can do to lower-income consumers.

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CUNA response: On the contrary, the type of business lending by credit unions is very likely to create jobs for people of modest means. A credit union business loan averages about \$150,000. As the U.S. Treasury Department 2001 study on business lending by credit unions reported, credit union member business loans are disproportionately made to businesses owned by households with modest incomes. Treasury reported that 25.3% of member business loans were made to members with household incomes of less than \$30,000 and another 20% were to household incomes between \$30,000 and \$50,000.

A credit union business loan can very well be that key “helping hand” for a person of modest means to reach the American dream.

Assertion: Credit unions do not want any measurement standards imposed to evaluate their service to people of modest means.

CUNA response: When a federal credit union applies for a community charter, or adds a low-income area to its field of membership, it must submit a business plan showing how it plans to serve all segments of the community. The credit union’s subsequent implementation of this plan is subject to review by NCUA examiners. Credit unions welcome this kind of oversight.

Credit unions’ objections to past proposals for data collection on service to low- and moderate-income people have been based on flaws in those specific proposals, not from any categorical rejection of some form of tailored, appropriate, and not unduly burdensome form of measurement. Application of bank-type Community Reinvestment Act (CRA) standards on credit unions is inappropriate for several reasons:

- Credit unions do not have the history of “redlining” that the banking industry does, and CRA’s approach was designed largely to deal with that history.
- CRA was intended in part to address the tendency of large banks to receive deposits from one community and lend them elsewhere, even in other countries, whereas credit unions are overwhelmingly local in nature, with few opportunities to engage in this abuse.
- CRA’s measurements take into account only lending activities and investments, completely ignoring the provision of low-cost depository service to promote thrift among the underserved, which has always been a fundamental purpose of credit unions.
- CRA was designed for financial institutions that can serve any customer who comes in the door, whereas the vast majority of credit unions remain occupationally based, and thus have less opportunity to serve low-income people.

The Community Action Plan (CAP) eventually by NCUA several years ago included many of the same flaws as CRA, and was rejected by the NCUA Board. The comments made by various members of the Ways and Means Committee during the hearing earlier this month will certainly encourage further discussion on this subject within the credit union movement about a system of measurement that takes into account the unique structure, history, mission, and regulatory restrictions on credit unions.

III. COMPETITION

Assertion: Credit unions are like mutual savings banks, which pay federal income taxes, so credit unions should be taxed too.

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CUNA response: Untaxed credit unions are not like taxed mutual banks. If they were alike, the simple solution for the mutual bank would be to convert to a credit union to eliminate taxation. So Congress should ask the mutual bank why it does not just convert to a credit union if both institutions are similar, rather than ask a credit union to try to explain why it's not like a mutual bank.

The honest answer is that credit unions and mutual banks differ, and differ significantly. The differences are not in the powers and services offered to consumers, because consumers everywhere expect a modern array of financial services. As our testimony explains in detail, the differences are fundamentally in structure. A mutual bank would have to limit its market, curtail its investments, stop permitting weighted voting, stop paying its directors, stop having proxy voting, and so forth. Credit unions are driven by service to their members. While mutual banks do not have the divided loyalties that banks with stockholders demonstrate, mutually organized banks clearly do not have the same mission as credit unions do.

Assertion: Many credit unions have broadened their fields of membership in recent years and grown quite large, and therefore should be taxed.

CUNA response: Larger or more complex credit unions have not strayed from their mission of providing financial services on a cooperative basis. Navy Federal Credit Union, the largest credit union in the United States, and GECU, a community credit union serving El Paso, Texas, testified about the diversity of programs they offer to meet the financial needs of members at all levels of the income spectrum. At they pointed out, for a financial cooperative to operate safely and soundly, it must have members who can save in order to have members who can borrow. In fact, economies of scale make it more likely for a larger credit union to offer more affordable and consumer-friendly services to members of modest means.

As CUNA's testimony discusses at length, the credit union tax-exemption was not granted because of small size, limited fields of membership, or limited services to the membership. Credit unions grow large because of the nature of their field of membership and their success in serving the people eligible for membership. A large credit union as measured by its aggregate assets does not mean that it is serving richer people, but more people. The largest credit unions in the country today have grown based on service to millions of workers from the military services, the airlines industry, federal, state and local governments and utility companies, among other consumers.

Assertion: Mutual thrift institutions and mutual insurance companies are taxed and have thrived, and there is no reason to believe that credit unions, if taxed, would not fare as well.

CUNA response: Taxing credit unions would erode credit unions' ability to build and maintain their net worth through retained earnings. Over time and under certain economic conditions, this erosion could present safety and soundness problems. Moreover, taxation would lead many credit unions to seriously consider whether they should convert, via a mutual bank conversion, to a stock bank. The reality is that many mutual thrift institutions have converted to stock banks over time. In fact, credit unions are getting sales pitches about the merits of conversion to mutual banks from law firms who have built a book of business on conversions and have found their potential client base notably shrinking.

The erosion of credit unions' ability to maintain solid net worth should be of particular concern to the Congress because of the unique federal share insurance program Congress created in 1984. Mutual insurance companies are not covered by a federal insurance program, and deposits in

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mutual thrift institutions are insured by the FDIC. Both the FDIC and the National Credit Union Share Insurance Fund are backed by the full faith and credit of the United States government.

Unlike the FDIC program, however, the NCUSIF by law requires credit unions to deposit an amount equal to 1% of their federally insured funds with the U.S. Treasury and to replenish the 1% from their retained earnings if financial troubles throughout the credit union system requires large NCUSIF payouts. As a credit union grows, it is required to add more funds to maintain the 1% level. The FDIC insurance program has no such continual support structure from the banking industry. Taxation of credit unions would require reconsideration of whether the unique NCUSIF's funding mechanism, which is beneficial to the American taxpayer, should continue.

Unlike mutual thrifts and mutual insurance companies, credit unions are run by volunteer boards, a fundamental characteristic of credit unions. This volunteerism helps ensure that management decisions are made for the benefit of members, not for the benefit of the decision-makers' own pockets. Taxation would undoubtedly also erode volunteerism since paying board and committee members would become a deductible expense.

Again, thank you for the opportunity to submit additional information for the November 3, 2005 hearing record. I will be happy to respond to any further questions you may have.

Sincerely,

A handwritten signature in cursive script that reads "Daniel A. Mica". The signature is written in black ink and is positioned above the printed name and title.

Daniel A. Mica
President & CEO