

## **SIZE DOESN'T MATTER IN A CREDIT UNION BEING A CREDIT UNION**

Some have suggested that the nation's very largest credit unions are in some sense no longer true credit unions, that they no longer live up to what Congress originally intended credit unions to be. They go on to argue that therefore large credit unions should no longer be tax-exempt. Yet, how many members a credit union has, or how many loans it provides does not affect the core characteristics of a credit union, or the real reasons for credit union's tax exemption. Further, large credit unions today fully live up to what Congress had in mind when it originally created the federal credit union charter and later granted the credit union tax exemption. It should also be remembered that a "large" credit union would still be modest sized by bank standards, and that the nation's three largest banking institutions each is larger than the entire credit union movement.

When Congress passed the Federal Credit Union Act in 1934 it defined a credit union as "a cooperative association organized . . . for the purpose of promoting thrift among its members and creating a source of credit for provident and productive purposes." (12USC§1752(1)) Congress first granted the tax exemption to federal credit unions in 1937 because "credit unions are mutual or cooperative organizations operated entirely by and for their members." (H.R. REP. NO. 1579, 75<sup>th</sup> Cong., 1<sup>st</sup> Sess. P. 2.) State credit unions are exempt from tax under Internal Revenue Code section 501(c)(14)(A). This section states that credit unions that are (1) operating on a nonprofit basis, (2) organized without capital stock, and (3) operating for mutual purposes can qualify for exemption. More recently, in the Credit Union Membership Access Act of 1998, the Congress found that: "Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means. (Pub. L. No. 105-219. August7, 1998.)

None of these statements of the core characteristics of credit unions or rationales for credit unions' tax exemption has anything to do with credit union size, field of membership restrictions, the range of services offered, or the extent to which credit unions might not compete with other financial institutions. Instead, they have everything to do with the cooperative structure of credit unions and their mission of providing affordable services to American households, especially those of modest means.

Credit unions are all about their members. Today credit unions serve 87 million members with affordable financial services. Twenty one million of those members belong to the one hundred credit unions with assets over \$1 billion. There is no relation between the size of an institution and the absence or presence of reasons to justify the tax exemption. Large credit unions are democratically controlled, not-for-profit cooperatives in every way that smaller credit unions are. The boards of directors of large credit unions are composed of volunteers just as they are at small credit unions. A large credit union may be more likely to offer a broader array of services, and to be a greater presence in a local community. However, neither factor makes it less a cooperative than a smaller credit union. No one suggests that as soon as the congregation of a church, synagogue or mosque exceeds a certain size, it should no longer be tax exempt. Likewise, it would be ludicrous to say the American Heart

Association should lose its tax exemption simply because of its size, while a small local charity should not.

Because of their size and efficiency, large credit unions are often more able to provide the benefits of the cooperative to members, such as lower loan rates and fees and higher dividend rates. Larger credit unions are also more able to offer special programs benefiting low- and moderate-income households. In a survey conducted in 2002, when asked how many of up to 18 services geared to low/mod income households they offered, only 6% of credit unions with assets below \$20 million offered at least half of the services. Fully 42% of credit unions with assets over \$500 million offered that many of the services. Large credit unions are also more likely than small credit unions to participate in outreach activities to attract low/mod income members, and to have added underserved areas to their fields of membership under NCUA's Access Across America program.

Here are some examples of what large credit unions do today:

Navy Federal Credit Union, the nation's largest with two and a half million members and \$25 billion in assets, is the epitome of a not-for-profit financial cooperative organized to provide its members with low-cost financial services. It is guided by an unpaid, volunteer, member-elected Board of Directors (one member, one vote.) Navy Federal serves most military and civilian personnel of the Navy and Marine Corps and their families, including almost 400,000 young active duty military personnel of modest means. Members can open a share account with only \$5, and the account has no monthly fees, minimum balance requirement, and earns dividends. The credit union operates 108 field offices around the world, from Keflavik, Iceland to Guantanamo Bay, Cuba, to Diego Garcia in the Indian Ocean to Bahrain. Half of the overseas offices operate at a loss, but they are maintained in order to serve military personnel on overseas deployments.

Government Employees Credit Union of El Paso has 240,000 members and \$1 billion in assets. It was originally chartered to serve federal employees in the El Paso area, but has since revised its charter to serve all those who live in El Paso County. As a result, its membership has broadened so that today more than 51% live in low-income areas. Over 80% of its membership is Hispanic. GECU of El Paso is a leader in the financing of affordable housing for its members in El Paso. Last year, 26% of all mortgages granted were for first-time homebuyers. The credit union also makes very small consumer loans for prudent purposes, as low as \$200 for prescription drugs or dental work.

San Antonio Federal Credit Union (230,000 members and \$1.8 billion in assets) is a pioneer in financing manufactured housing for members with limited incomes. For many Americans, high quality manufactured housing is a cost effective alternative to the escalating costs of traditional site built homes. Manufactured housing must meet manufacturing standards that meet or often exceed requirements of some local codes. Since entering the manufactured housing finance market in 2002, San Antonio Federal Credit Union has made over 3,000 high quality portfolio loans for this affordable housing. The average loan size is about \$50,000. The credit union is also developing the infrastructure to assist other credit unions around the country to serve this market.

Some banker groups suggest that credit unions, especially larger ones, are unfair competitors for banks. Yet all the evidence suggests that banks and thrifts continue to thrive in the presence of credit unions. The FDIC recently reported that banks recorded record profits for the fourth year in a row. Average bank return on assets (ROA) has exceeded 1% for the past 12 years, averaging 1.23%. And credit unions are only growing marginally faster than banks. In the decade ending in 2004, total banking institution assets grew at a compound annual rate of 7.25% compared to 8.4% for credit unions. Credit unions now account for 6.2% of the combined assets of all depository institutions. At the growth rates of the past decade, it will take until the year 2053 for the credit union share to climb to just 10%.

The health of the banking industry over the past decade has not been confined to just large banks. At a 2003 Chicago Federal Reserve Bank conference, Federal Reserve Gov. Mark Olson said: "The year that just ended was one of record profits for the industry as a whole, and for community banks in particular." and "Community banking has a long history of strength and success and a bright future. The past year was a good one for community banks. Once again the vitality and adaptability of the community banking franchise were amply demonstrated."<sup>1</sup> Two Federal Reserve economists have recently described the strong performance of the nation's smaller banks. They found that "small banks have grown considerably more rapidly than large banks and have tended to meet or exceed them in some measures of profitability."<sup>2</sup>

Despite the protestations of community bankers, credit unions are not eroding their market share. The share of total depository institution assets held by community and smaller regional banks (all but the top 100 banking institutions in the US) has indeed plummeted from 53% in 1992 to 27% in 2004. However, over the same period, the share of credit unions has remained stable at about 6%. It is the largest 100 banks (larger regionals, super regionals, and money center banks) that have taken the market share, from 41% in 1992 to 67% in 2004. This is shown in the accompanying chart.

If credit unions had such an "unfair" advantage over banks, one can wonder rhetorically why we have not seen a wholesale conversion from bank to credit union charters. The reason no commercial bank has converted to a credit union is that doing so would expose them to democratic ownership and control, would likely cause banker salaries to decline dramatically, and would force the institutions to adhere to a much more restrictive regulatory regime.

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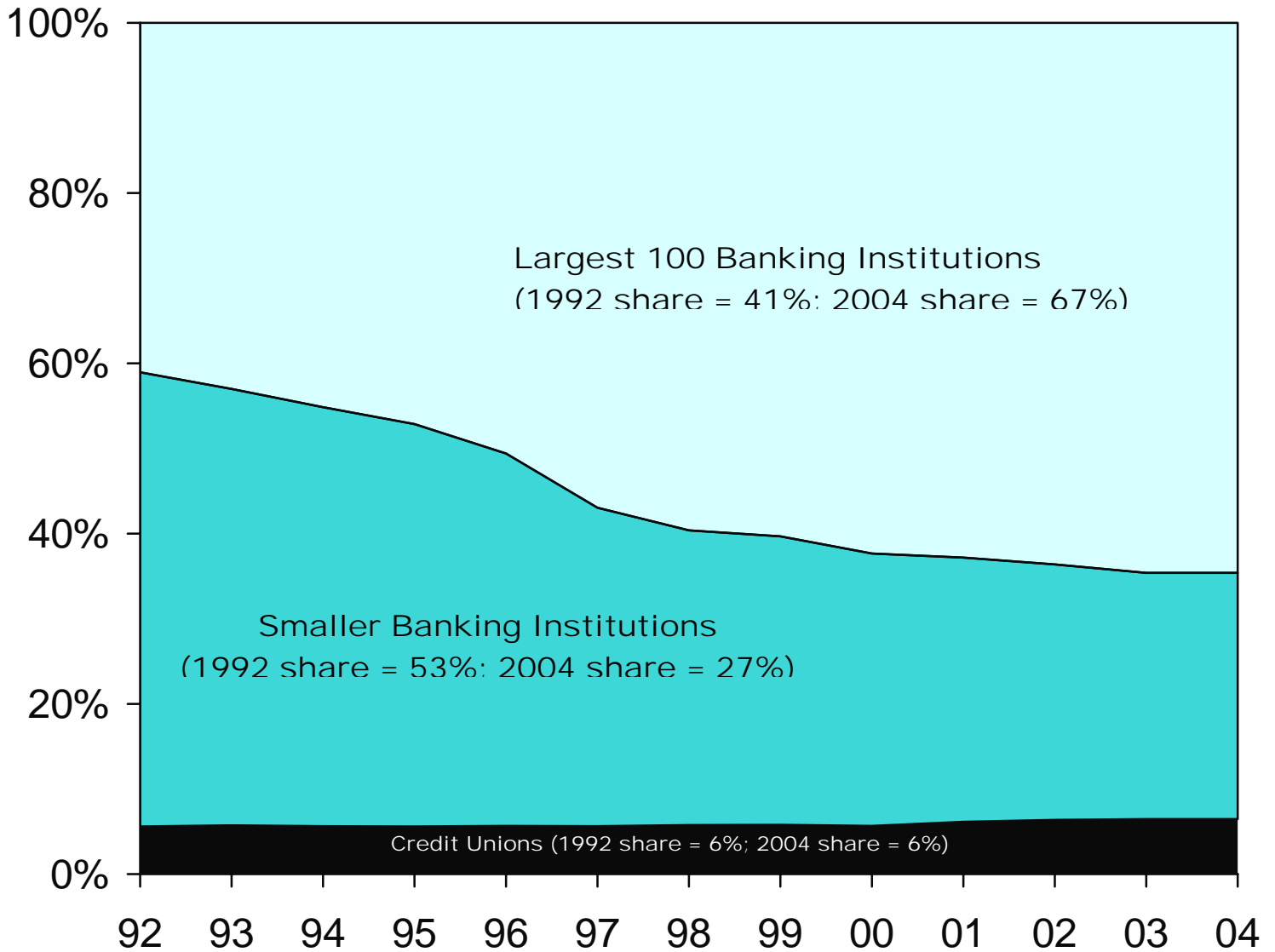
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<sup>1</sup> Comments before the 2003 Chicago Federal Reserve Bank Conference: Whither the Community Bank?

<sup>2</sup> William F. Bassett and Thomas F. Brady. *The Economic Performance of Small Banks, 1985-2000*. Federal Reserve Bulletin, November 2001.

# Small Bank Asset Share Declines Are Due to The Increasing Dominance of Mega-Banks



Sources: FDIC, NCUA, CUNA E&S. "Banking Institutions" include commercial banks and savings & loans.  
"Smaller Banking institutions" are defined as all banking institutions smaller than the Largest 100.