



Credit Union National Association

cuna.org

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March 6, 2012

The Honorable Timothy Johnson  
Chairman  
Committee on Banking, Housing and  
Urban Affairs  
United States Senate  
Washington, DC 20510

The Honorable Richard Shelby  
Ranking Member  
Committee on Banking, Housing and  
Urban Affairs  
United States Senate  
Washington, DC 20510

Dear Chairman Johnson and Ranking Member Shelby:

On behalf of the Credit Union National Association (CUNA), I am writing regarding today’s hearing on “Spurring Job Growth through Capital Formation While Protecting Investors.” CUNA is the largest credit union advocacy organization in the United States, representing nearly 90% of America’s 7,300 state and federally chartered credit unions and their 94 million members.

While there are signs that the economy is recovering, small business owners still view access to credit as a key challenge to the success of their small business. According to a recent poll commissioned by the American Sustainable Business Council, the Main Street Alliance and the Small Business Majority, 90% of small business owners believe that the availability of small business loans is a problem, and 60% have faced difficulty trying to obtain loans that would grow their small business. Further, the survey found that 90% of small business owners support making it easier for community banks and credit unions to make loans to small businesses.<sup>[1]</sup>

As you put together a package of capital formation legislation, we strongly encourage you to include Senator Mark Udall’s Small Business Lending Enhancement Act (S. 509) in the package. This legislation would permit well-capitalized credit unions with a strong history of business lending that are operating near the statutory credit union member business lending cap to apply to the National Credit Union Administration (NCUA) to lend beyond the statutory cap. The legislation enjoys bipartisan support in the Senate and the House as well as the endorsement of the Department of Treasury. We estimate that if this bill became law, credit unions could lend an additional \$13 billion to small businesses, helping them create 140,000 new jobs in the first year after enactment, at no cost to taxpayers.<sup>[2]</sup>

<sup>[1]</sup> “Opinion Survey: Small Business Owner Opinions on Access to Credit and Proposals to Boost the Economy.” American Sustainable Business Council, the Main Street Alliance, and the Small Business Majority.

<sup>[2]</sup> A description of the methodology behind these estimates is included in the attachment to this letter.



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## **Bank Opposition Should Be Disregarded**

The only opposition to S. 509 comes from organizations representing the banks that pulled back access to credit from their small business customers during the financial crisis. Historically, these groups have raised a series of objections claiming that credit union business lending would undermine safety and soundness, suggesting that raising the credit union business lending cap is unnecessary because few credit unions are near the cap, and arguing, almost unbelievably, that there is no demand for small business lending. The attached document thoroughly and completely responds to these and other objections which have been raised over the last several years by the banking trade associations.

No one should forget that the banks that oppose S. 509 bill are the same banks Congress bailed out in 2008 with TARP, the same banks to which Congress made available \$30 billion of taxpayer money to lend to small businesses, the same banks that took only a fraction of that money and used most of what they took to refinance their TARP obligations.

Today, these banks are asking Congress for reduced regulatory burden with a promise that the changes they seek will benefit small businesses. At the same time, the American Bankers Association says it would rather see this Committee's effort fail than to see S. 509 enacted into law.<sup>[3]</sup> After devastating the housing market, retreating from the small business market, receiving taxpayer bailout after taxpayer bailout, being begged by the government to lend to small businesses and refusing that call, America's banks now come to Congress with the message: they will oppose their own regulatory relief legislation if Congress allows the credit unions to provide more assistance to small businesses.

It is clear: the banks are not interested in spurring growth through capital formation. They would rather see their legislation wither on the vine than see well-capitalized and experienced credit unions increase their lending to small businesses.

What is truly troubling about the banker objections, however, is not only their chronic and comprehensive misrepresentation of the facts or their recent turn to name calling, but that they completely miss the point of what Senator Mark Udall's bill is about – small business lending.<sup>[4],[5]</sup> Their institutions are not doing enough of it; credit unions want to do more; and small businesses need more. That is why this legislation is supported by dozens of small business organizations that understand the challenges small businesses have faced during the financial crisis and that the solution to the

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<sup>[3]</sup> Keating, Frank A. "Topic A: Credit Unions' False Choice," Washington Perspective. American Bankers Association. March 2, 2012.

<sup>[4]</sup> "ICBA Won't Let Allow CUs to Latch Onto Reg-Relief Bill," ICBA Newswatch Today. March 1, 2012. <http://www.icba.org/publications/NewsletterDetailNWT.cfm?ItemNumber=121786#story1>.

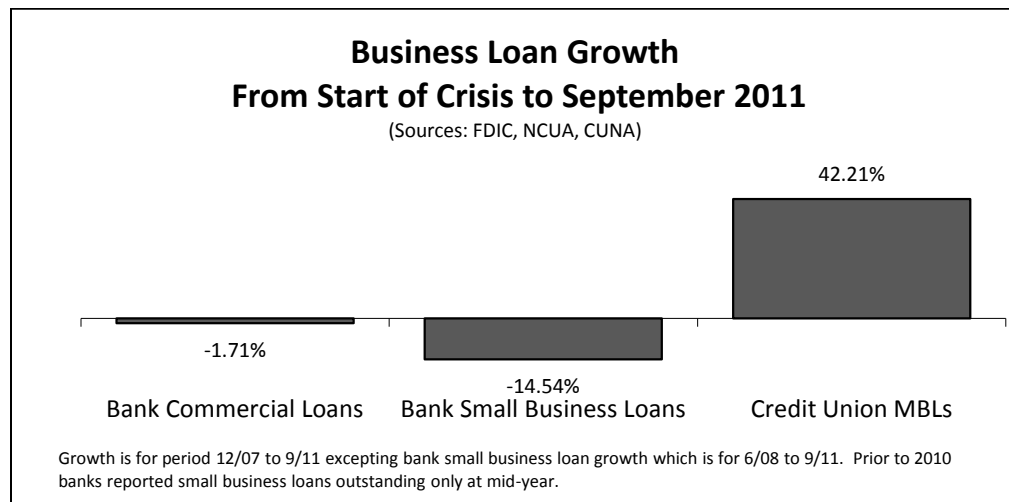
<sup>[5]</sup> "Credit Unions' Push Puts Bankers in a Tailspin," National Journal. February 7, 2012.

unemployment problem we face is providing small businesses with greater access to credit, not restricting it.<sup>[6]</sup>

The banking lobby's position on this Committee's effort and S. 509 bill provides a vivid example of a lesson that small businesses have painfully learned over the course of the last several years – they cannot afford to have their only financing option be America's banks.

### **Credit Unions Are an Increasingly Important Partner for America's Small Businesses**

Small businesses need a partner that will stand with them and not retreat at the first sign of trouble. In recent years, credit unions have been that type of partner, but a number of banks have not. From June 2001 to June 2011, business loans at credit unions grew at an annual rate of 22.3%, over three times faster than the 6.4% annual growth rate of all credit union loans. During the financial crisis, credit unions expanded their business lending portfolios by more than 42%, while the bankers pulled back, reducing their portfolios nearly 15%.



<sup>[6]</sup> This legislation has been endorsed by the following organizations: American Consumer Institute; American Small Business Chamber of Commerce; Americans for Tax Reform; AMT-The Association for Manufacturing Technology; CCIM Institute; Center for Risk, Regulation & Markets at the Heartland Institute; Competitive Enterprise Institution; Council of Insurance Agents and Brokers; Ford Minority Auto Dealers; Freedom Action; Hardwood Federation; Institute of Real Estate Management; League of United Latin American Citizens (LULAC); Multifunding; National Association of the Self-Employed; National Association of Mortgage Brokers; National Association of Professional Insurance Agents; National Association of Realtors®; National Association of Small Business Contractors; National Cooperative Business Association; National Cooperative Grocers Association; National Council of Textile Organizations; National Farmers Union; National Small Business Association; NCB Capital Impact; Newtek Business Services; Progressive Policy Institute; Realtors Land Institute; Small Business Majority; Society of Industrial and Office Realtors; and U.S. Women's Chamber of Commerce.

Therefore, it was not surprising to us when the National Federation of Independent Businesses (NFIB) recently reported that the number of small business owners that list a credit union as their principal financial institution has doubled since 2009.<sup>[7]</sup> This demonstrates a growing reliance on credit unions as the economy recovers from the financial crisis.

### **Credit Unions with the Most Business Lending Experience Are Approaching the Cap, Threatening the Business Lending Growth of Recent Years**

Unfortunately, the statutory cap on credit union business lending threatens this growth, and this is why Congress must enact Senator Mark Udall's bill.

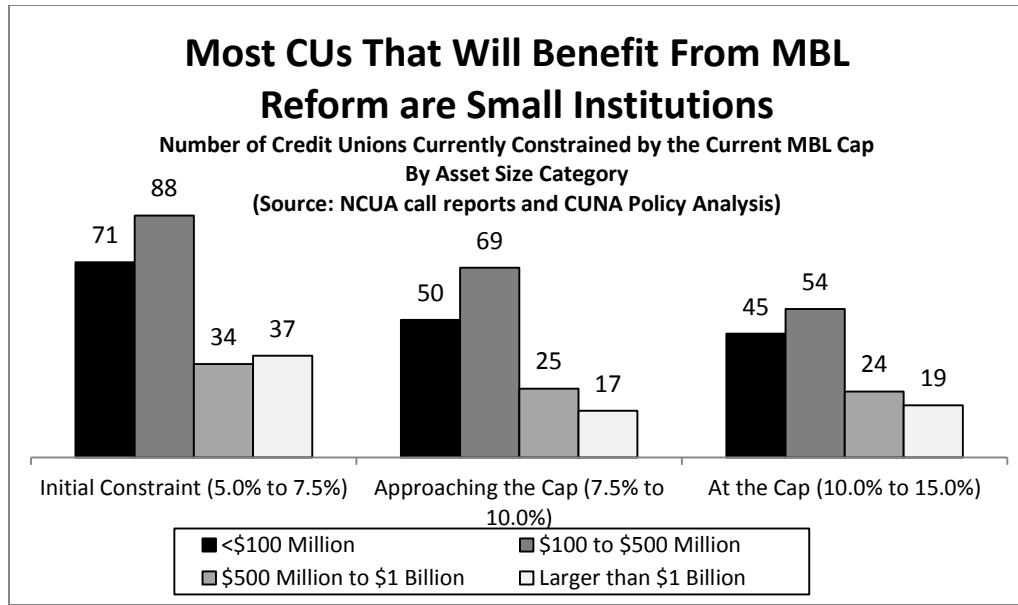
The credit unions with the most experience in business lending are the ones that have contributed the most to the growth in credit union business lending over the last several years. Credit unions which have exceeded half of their statutory capacity account for nearly three-quarters of credit union business loans. These credit unions are the ones now actively making choices to avoid hitting the cap. As a result, many have suspended small business loan offerings to new borrowers in order to continue to be a source of credit for existing borrowers; others, unfortunately, have had to suspend their offerings to small businesses.

The bank lobbyists would have Congress believe only a small number of credit unions are impacted by the cap; recently, the American Bankers Association asserted that only 30 large credit unions are affected by the cap.<sup>[8]</sup> In reality, there more than 500 credit unions managing the cap today, and it is quite a stretch of the truth to suggest that these are only large credit unions.

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<sup>[7]</sup> Dennis Jr., William J. "Small Business, Credit Access, and a Lingering Recession." National Federation of Independent Businesses. January 2012. 2.

<sup>[8]</sup> Keating.



Nearly 90% of all credit unions constrained by the cap are smaller institutions with less than \$1 billion in total assets and nearly three-quarters of these constrained credit unions have less than \$500 million in total assets.<sup>[9]</sup> More specifically:

- 84% of credit unions now facing initial constraints due to the cap have less than \$1 billion in assets;
- 89% of credit unions approaching the cap have less than \$1 billion in assets; and
- 87% of credit unions at the cap have less than \$1 billion in total assets.

Regardless of size, the credit unions which are approaching the cap are the ones with the most experience with safe and sound small business lending; in fact, they account for 75% of all business loans subject to the cap and have contributed almost 65% of the recent growth. While more credit unions will undoubtedly follow their lead, these are the credit unions that have the capacity now to use Senator Mark Udall's legislation to benefit of their small business-owning members.

### **Senator Mark Udall's Bill is a Common-Sense Approach to Increase Small Business Lending in a Safe and Sound Manner and Should be Included in any Capital Formation Legislation**

Senator Mark Udall has proposed to reform the credit unions business lending cap. As noted, we estimate that credit unions could lend an additional \$13 billion to

<sup>[9]</sup> The banking industry customarily uses this \$1 billion threshold as the definition of "community bank" though some analysts are now beginning to use \$10 billion as a threshold definition. Under CRA regulations, federal banking regulators today define "small" institutions as banking institutions with \$1.16 billion or less in total assets.

small businesses in the first year after enactment, helping them to create 140,000 jobs in this time frame, at no cost to taxpayers.

The legislation includes safeguards designed to protect the National Credit Union Share Insurance Fund (NCUSIF) from additional risk and to ensure that credit unions lending beyond the current cap do so in a safe and sound manner. Specifically, the legislation would permit qualifying credit unions to apply to the National Credit Union Administration (NCUA) for authority to lend up to 27.5% of their assets to small businesses. In order to be considered by NCUA, a credit union would have to be well-capitalized, operating in excess of 80% of the statutory cap on business lending for one year prior to applying, and have at least a five year history of sound underwriting and serving member business loans. After being approved to lend beyond the statutory cap, the credit union would be subject to portfolio growth limits to ensure that its business loan portfolio does not grow more than 30% per year. If a credit union approved to lend beyond the statutory cap falls below the level necessary to be considered well-capitalized, it would have to cease business lending.

The banking lobbyists would like Congress to choose between banks and credit unions in determining whether to include Senator Mark Udall's bill in the capital formation package; however, if this view prevails, small businesses lose. The banks are shameless in their opposition to legislation that would make more capital available to small businesses, and allowing them to dictate what is included or excluded from this package will further frustrate small businesses' ability to contribute to the recovery.

Credit unions take a great deal of pride in serving their members, including those who own small businesses. They have the capacity to do more to help small businesses; they have the expertise and experience to do more. They simply need Congress's permission. The banks have stood in the way long enough. We encourage you to include Senator Mark Udall's legislation in the capital formation package.

On behalf of America's credit unions and their members, thank you very much for your consideration.

Best regards,

A handwritten signature in black ink, appearing to read "Bill Cheney", with a long, sweeping underline that extends to the right.

Bill Cheney  
President & CEO

# **CUNA's Response to Objections to Raising the Credit Union Member Business Loan Cap**

CUNA Research and Policy Analysis  
March 1, 2012

Banking trade associations object to the expansion of credit union business lending authority. This paper provides a summary of the objections made by those opposed to lifting the business lending cap, and outlines responses to those claims.

By way of background, as of September 2011, credit unions held \$40 billion in loans to small businesses. This represents 5.6% of all small business loans at depository institutions.<sup>1</sup> Were a doubling of the business lending cap at credit unions to eventually lead to a doubling of credit union business lending, that would leave at least 88% of the market to banking institutions. To the extent the additional credit union loans were made to borrowers whose credit demands would not have been met by banking institutions, the reduction in the banks' share would be less.

Most credit unions are currently under an arbitrary business lending cap of 12.25% of assets, established by law in 1998. Prior to that date, there was no business lending cap at credit unions. Although the majority of credit union lending has always been in loans to consumers, credit unions have engaged in business lending since their inception in the US in 1908. The cap is expressed as 1.75 times net worth, but only net worth up to the level required to be well-capitalized (7%) can be counted. Thus, credit unions with excess capital are not permitted to hold additional business loans. Approximately 55 business lending credit unions are grandfathered (i.e., not subject to the cap) because they had a long history of significant involvement in the MBL arena at the time the cap was imposed.

## **Banker Claim: Raising the cap would undermine credit union safety & soundness.**

**Facts:** Credit unions have a long history of engaging in safe and sound business lending. Business lending at credit unions is much safer than at other institutions. According to data collected by NCUA and FDIC:

- Credit union member business loan net charge-off rates have been significantly lower than bank rates year-in and year-out for over a decade. Since 1997, credit union member business loan net charge-off rates have averaged 0.22%, a figure that is less than **one-fourth** the 0.91% bank average over the same period.<sup>2</sup>
- More recently, the financial crisis and recession have increased losses at all lenders. However, the increase in loss rates at credit unions pales in comparison to bank results. During the first nine months of 2011, credit unions charged off commercial business loans at a 0.74% rate – roughly one quarter lower than the 0.94% rate reported by banks over the same period.<sup>3</sup>
- Compared to other loans at credit unions, business loan net charge-off rates are lower than net charge-off rates on credit union consumer loans and nearly identical to the net charge-off rates in credit union real estate loan portfolios.<sup>4</sup>

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<sup>1</sup> NCUA Call Reports and FDIC Statistics on Depository Institutions.

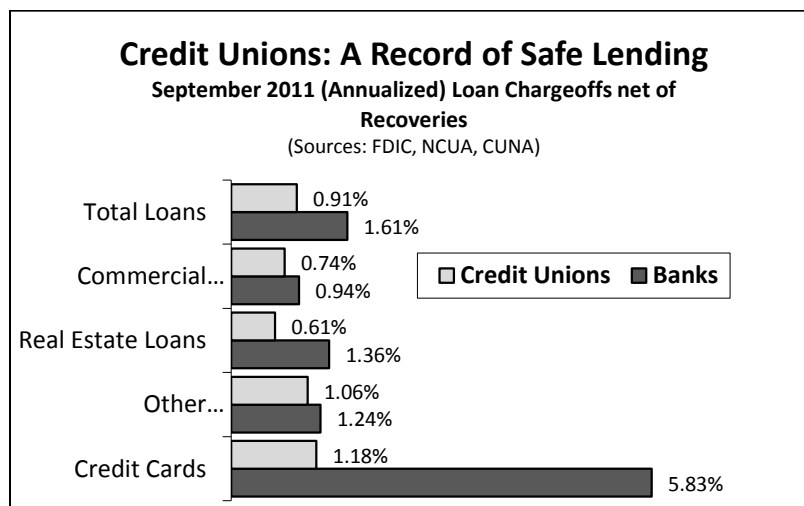
<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

<sup>4</sup> NCUA Call Reports.

- NCUA Chair Deborah Matz, in her June 2011 testimony before the Senate Committee on Banking, Housing and Urban Affairs, stated: “While MBL delinquencies and losses increased significantly during the economic downturn, they did not have a major impact on the safety and soundness of the vast majority of credit unions.” Of the 55 credit union failures in 2009 and 2010, only one failure was primarily related to MBLs. MBLs were one of several factors contributing to the failure of eight other credit unions. Thus, the vast majority (46) of credit union failures during this period were unrelated to member business lending.”<sup>5</sup>

As shown in the following graph, relatively low charge-offs are NOT confined to credit union business lending portfolios. Credit union net charge-offs are substantially lower than bank net charge-offs in each loan category. This lower loss experience at credit unions is the result of their operation under a cooperative structure, which provides much lower incentives to take on risk than a for-profit structure.<sup>6</sup>



Further, most credit unions have excess liquidity today which is depressing their overall earnings. Moving assets from low-yielding investments into higher-yielding member business loans, even after accounting for credit losses on those loans, will increase credit union earnings, capital contributions, and overall safety and soundness.

Finally, the credit union regulator, the National Credit Union Association (NCUA), has full authority to supervise credit union business lending. That regulation is no doubt an important reason behind the very low loss rates experienced on credit union business loans over the past decade. Recently, NCUA Chairman Matz emphasized in a February 24, 2010 letter to Treasury Secretary Geithner<sup>7</sup>: “If legislative changes increase or eliminate the aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns.”

<sup>5</sup> Senate Committee on Banking, Housing, and Urban Affairs: Credit Unions: Member Business Lending. June 16<sup>th</sup> 2011. Statement of the Honorable Debbie Matz, Chairman Nation Credit Union Administration.

<sup>6</sup> Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, *Journal of Banking and Finance*, 20(September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.

<sup>7</sup> [http://www.ncua.gov/news/press\\_releases/2010/MA10-0225MatzLending.pdf](http://www.ncua.gov/news/press_releases/2010/MA10-0225MatzLending.pdf)



**Banker Claim: Raising the cap would not create jobs or reduce unemployment. However, even if it did do so, the CUNA-produced estimate of job creation is too high.**

**Facts:** Relaxation of artificial statutory lending restrictions will increase the efficiency of capital allocation in the economy. This will promote more lending, more spending, more job creation and higher economic growth. Recent bank business loan contraction suggests that, at least to some degree, credit unions will be making loans that banks are not making.

CUNA estimates that raising the business lending cap would allow credit unions to increase business lending by up to \$13 billion in the first year after the cap is lifted. This estimate is based on three conservative assumptions, and is described below:

1. We assume that “grandfathered” credit unions (i.e., the approximately 100 credit unions that are currently above the 12.25% cap and/or not federally insured) do not increase their lending when the cap is raised.
2. We assume that credit unions that are not currently engaged in business lending would enter the market in an amount equal to 1% of total assets on average under the new authority. We further assume that only 40% of the increased activity would occur in the first year.
3. We assume that all other business lending credit unions lend in an amount equal to their current “use” rate, i.e., all non-grandfathered current business lending credit unions would eventually just over double their business lending. Our conservative estimate assumes that only 40% of the increased lending would occur in the first year.
4. Estimates produced using these three assumptions are further adjusted as follows:
  - a. Credit unions with net worth/assets  $\leq$  6% are assumed to have no MBL growth;
  - b. Credit unions with net worth/assets between 6% and 7% remain at the current 12.25% cap; and
  - c. Credit unions with MBL/assets  $\geq$  10% are limited to a 30% increase in MBLs in the first year.

Applying these assumptions produces an estimate of a \$12.7 billion first-year increase in lending, which we have rounded to \$13 billion. That would represent an approximately 30% increase in credit union business lending. This is certainly plausible considering that credit union business loan portfolios increased by 30% or more in four of the past nine years. That growth has slowed recently as an increasing number of credit unions have begun to approach their caps.

Because many bank business loan portfolios are shrinking we assume that the new loans would largely be loans that would not otherwise be made by banks. We further assume that the \$13 billion increase in lending would be a "new normal" - that the first-year addition would represent a permanent addition to loan volume in credit union portfolios. In this regard, the increase in lending can be viewed as ARRA-like stimulus similar to direct spending. Thus, we assume that the additional lending would produce jobs at a rate that is similar to the estimates published by the Council of Economic Advisors (CEA) in its May 2009 estimates of job creation.<sup>8</sup>

Using these assumptions and rounding, each \$92,000 in additional MBL lending on the part of the nation's credit unions will create one additional job. Therefore expanded credit union MBL authority will result in an estimated first-year increase of 138,000 new jobs nationally.

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<sup>8</sup> See: <http://www.whitehouse.gov/administration/eop/cea/Estimate-of-Job-Creation/>. Note: Use of Small Business Administration survey data would produce a much larger estimate of job creation. Since CUNA's aim was to produce a conservative estimate we chose not to use the SBA job creation data.

A recent report, compiled by David M. Smith, Associate Professor of Economics at Pepperdine University, finds that CUNA's assumptions and estimates outlined above are "conservative and well within the bounds of a reasonable projection."<sup>9</sup>

**Banker Claim: There is no evidence to support the contention that credit for small businesses is in short supply, as banks have been lending to small businesses in their communities throughout the economic crisis.**

**Facts:** There is no doubt that there has been a reduction in the demand for business credit as a result of the recession. However, there is also considerable evidence that a significant contraction in the supply of business credit has contributed to the reduction in credit outstanding.

For example, the Pepperdine Capital Markets Project has recently been conducting a survey of U.S. small businesses in conjunction with Dunn and Bradstreet. Data collected during the week of 8/29/11 from a sample of over 5,500 U.S. small business owners finds that nearly one-quarter sought a bank loan in the preceding 12 month period. Among those that sought bank financing fully 57% indicated that they were not successful in obtaining financing. This is a clear indication that a substantial number of small businesses continue to need more access to capital.<sup>10</sup>

Not surprisingly, a large number of small business owners are telling policy makers that they are being turned away by their banks. That is the primary reason that Congress has held several hearings on this subject.

Moreover, recent data from financial institution regulatory reports supports this view. Call Report data suggests that banks – both large and small – are turning away many business borrowers.

In the year ended September 2011, community bank commercial loans outstanding declined by -1.5% according to FDIC call report filings, while credit union business loans increased by 4.3% over the same period.<sup>11</sup>

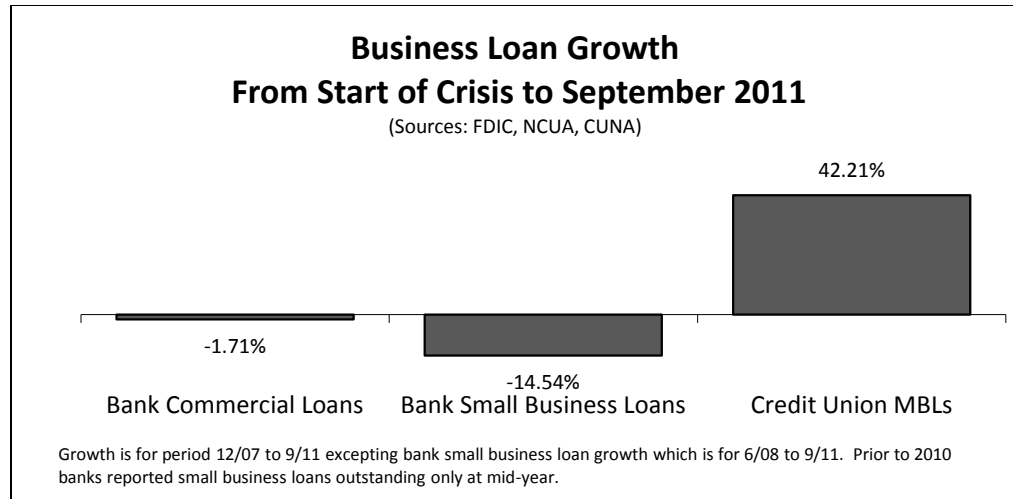
More broadly, as shown in the following graph, total bank business loan portfolios have declined over the cycle, while credit union business loan portfolios grew at a healthy rate. If indeed the contraction in business credit outstanding were due solely to reduced demand, credit union lending would have declined as it did at banks, rather than registering a 42% increase in the December 2007 to September 2011 period. Again it is important to note that credit union growth has slowed recently as an increasing number of credit unions have begun to approach their caps.

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<sup>9</sup> David M. Smith. *Raising the Credit Union Member Business Lending Cap: Projected Labor Market Impact*. September 2, 2011. Summary results available through CUNA.

<sup>10</sup> See: <http://bschool.pepperdine.edu/appliedresearch/research/pcmsurvey>. Survey of firms with less than \$5 million in annual revenues.

<sup>11</sup> Community banks are here defined as those with \$10 billion or less in total assets.



Recent academic research underlines the role of credit unions as a counter-cyclical presence in the marketplace. In a recently-published SBA publication Professor James A. Wilcox finds that small business loans (SBLs) at credit unions “tended to partially offset declines in business loans at banks. Credit unions’ increasing share of SBLs and the estimated offsets suggest that credit unions are increasingly important sources of SBLs as a longer-run development and in response to fluctuations in SBLs at banks”.<sup>12</sup>

The data is clear: allowing credit unions to extend loans to businesses that need credit will add fuel to a self-sustaining economic expansion. Increasing competition in the small business loan market will increase the efficiency of capital allocation. Businesses will choose credit union loans over community bank loans only if credit unions provide a product that provides an overall better value. And credit union competition will ensure that banks are treating their small business customers more fairly.

**Banker Claim: Raising the cap is unnecessary because relatively few credit unions are now near the 12.25% member business lending cap.**

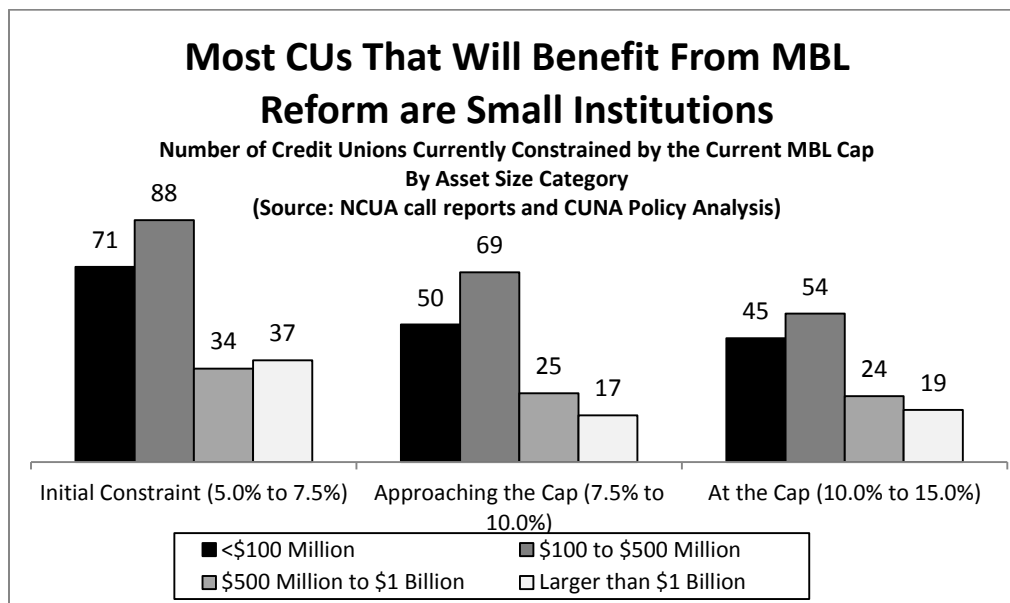
**Facts:** Hundreds of credit unions are now at or near the cap and many thousands of credit unions – both large and small – will benefit from a restoration of business lending authority. More importantly, many hundreds of small businesses that currently lack access to credit will borrow and tens of thousands of those currently unemployed can be put back to work – all at no cost to the taxpayer. Specifically, publicly available data shows<sup>13</sup>:

2. More than 500 credit unions are or will be bumping up against the cap in the next several years. Most of these credit unions already are looking for ways to moderate their business loan growth. They include:
  - A total of 230 credit unions with MBL/asset ratios of 5.0% to 7.5% that are experiencing initial constraints of the cap;
  - A total of 161 credit unions with MBL/asset ratios of 7.5% to 10.0% that are approaching the cap;
  - A total of 142 non-grandfathered credit unions that are essentially at the cap with MBL/asset ratios of 10.0% or more.

<sup>12</sup> James A. Wilcox. *The Increasing Importance of Credit Unions in Small Business Lending*. SBA Office of Advocacy. Release Date: September 2011.

<sup>13</sup> NCUA call reports and CUNA Policy Analysis.

3. Nearly 90% of all credit unions constrained by the cap are smaller institutions with less than \$1 billion in total assets<sup>14</sup> and nearly three-quarters of these constrained credit unions have less than \$500 million in total assets. More specifically:
- 84% of credit unions now facing initial constraints due to the cap have less than \$1 billion in assets;
  - 89% of credit unions approaching the cap have less than \$1 billion in assets; and
  - 87% of credit unions at the cap have less than \$1 billion in total assets.



For the past several years, business loans have been the fastest growing component of credit union lending (the other two sectors being residential mortgage loans and non-residential consumer loans.) From June 2001 to June 2011, business loans at credit unions grew at an annual rate of 22.3%, over three times faster than the 6.4% annual growth rate of all credit union loans.

The banking lobby often argues that the cap affects only a small number of credit unions but this represents a complete misunderstanding of how the cap functions, and how it unnecessarily limits credit union small business lending.

Thousands - not a small handful - of credit unions are impacted by the cap because:

- 1) The cap constrains lending at nearly all credit unions engaged in business lending - even among those with relatively low MBL/asset ratios. That's because ALL lenders must establish arbitrary operational buffers well below the cap to ensure that current borrowers have future access to credit (either new loans or credit line extensions) as their businesses grow. These artificial operational buffers significantly and unnecessarily constrain new loan growth and small business access to capital.
- 2) The cap is an artificial barrier to entry - discouraging thousands of non-MBL credit unions from entering the business lending market.

### Constraints on Current MBL CUs

<sup>14</sup> The banking industry customarily uses this \$1 billion threshold as the definition of "community bank" though some analysts are now beginning to use \$10 billion as a threshold definition. Under CRA regulations, federal banking regulators today define "small" institutions as banking institutions with \$1.16 billion or less in total assets.

As of September 2011, there were 1,836 non-grandfathered, business lending federally insured credit unions without a low-income designation with \$28.6 billion of business loans on their books. They are shown on the table below in terms of their proximity to the cap:

<b>MBL Credit Union Profile</b>						
<b>Data as of September 2011. Excluding Non-Grandfathered and Low Income CUs</b>						
<b>Sources: NCUA and CUNA.</b>						
<b>MBLs/Assets</b>	<b># of CUs</b>	<b>Percent of These CUs with &lt; \$500 Mil. in Assets</b>	<b>Total MBLs (Billions)</b>	<b>Percent of Total Non-Grandfathered MBLs</b>	<b>Growth in MBLs in Year Ending June 2011</b>	<b>Estimated Average Number of Years to Reach Cap at Recent Growth Rates</b>
>0% to 5.0% (not yet constrained)	1,303	86%	\$7.04	24.6%	15.5%	> 5 years
5.0% to 7.5% (initial constraint)	230	69%	\$6.84	23.9%	9.6%	2.7 years
7.5% to 10.0% (approaching the cap)	161	74%	\$7.05	24.7%	3.6%	2.5 years
>10.0% to 15% (at the cap)	142	70%	\$7.65	26.8%	1.9%	< 1 year
<b>Totals</b>	<b>1,836</b>	<b>82%</b>	<b>\$28.58</b>	<b>100.0%</b>	<b>7.2%</b>	

The following is how these various groups of credit unions are affected by their proximity to the cap, and the implications for future business lending by credit unions:

- A total of 230 credit unions hold business loans between 5% and 7.5% of assets. These credit unions will be capped within 2.7 years at recent growth rates. They held \$6.8 billion in business loans at September 2011 and their business loans grew by \$2.3 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- Another 161 credit unions hold business loans between 7.5% and 10% of assets. These credit unions will be capped within 2.5 years at recent growth rates. They held \$7.1 billion in business loans at September 2011, and their business loans grew by \$1.5 billion over the preceding three years. Their business lending will have to slow dramatically in the coming few years without an increase in the cap.
- 142 credit unions, with \$7.7 billion in business loans outstanding, had business loans of more than 10% of assets. These credit unions are essentially capped or will reach the cap in the next twelve months. In the three years ending September 2011, business loans outstanding at these credit unions rose by only \$778 million. They will be able to contribute very little to future business loan growth without an increase in the cap.

Taken together these 533 credit unions now account for 75% of all business loans subject to the 12.25% cap. These credit unions have been the major contributors to credit union business loan growth over the past few years – accounting for 64% of total growth in non-grandfathered credit unions.

When the business lending growth in these credit union is contrasted, the cap limitations are clearly seen reflected in slower growth rates among credit unions that are closer to the cap. In fact, the aggregate data shows:

- Credit unions with 5% to 7.5% MBL/Asset ratios saw portfolios increase by 9.6% in the year ending September 2011;
- Credit unions with 7.5% to 10% MBL/Asset ratios experienced an increase of 3.6%;

- Credit unions with more than 10% MBL/Asset ratios saw an increase of 1.9%. These credit unions will be able to contribute very little to future business loan growth without an increase in the cap.

Over the next few years, the business loan growth of this group of credit unions will disappear without an increase in the cap. Banks may claim that only a “handful” of credit unions are actually capped, but a total of more than 500 credit union will be bumping up against the cap in the next one, two or three years. Because of that, most of these credit unions are already looking for ways to moderate their business loan growth.

Both the number of credit unions approaching the cap and the total amount of non-grandfathered MBLs held by these credit unions has increased dramatically in the past ten years: Ten years ago, only 10% of non-grandfathered MBL credit unions were constrained by the cap (i.e., held MBLs over 5% of assets). Today, nearly 30% are constrained. In addition, ten years ago only one-half of MBLs resided in constrained credit unions. Today, fully three-quarters of MBLs are on the books of constrained credit unions. **Without an increase in the cap, credit union business lending will have to slow.**

<b>MBL Credit Unions: Distribution Changes</b>						
<b>Data as of June. Excluding Non-Grandfathered CUs.</b>						
<b>Sources: NCUA and CUNA.</b>						
<b>MBLs/Assets</b>	<b>Percent of Total Non-Grandfathered MBL Credit Unions</b>			<b>Percent of Total Non-Grandfathered MBLs</b>		
	<b>2001</b>	<b>2006</b>	<b>2011</b>	<b>2001</b>	<b>2006</b>	<b>2011</b>
>0% to 5.0%	90.3%	79.6%	71.6%	51.0%	32.2%	25.3%
5.0% to 7.5%	4.3%	8.7%	12.5%	22.8%	20.3%	24.0%
7.5% to 10.0%	3.0%	6.0%	7.8%	15.6%	19.5%	24.6%
>10.0% to 15%	2.4%	5.7%	8.1%	10.5%	28.0%	26.1%

The banks also claim that the credit unions constrained by the cap are a “new breed” of large credit unions. Again, this is false: Nearly 90% of all credit unions that are or soon will be bumping up against the cap are smaller institutions with than \$1 billion in total assets and nearly three-quarters of have less than \$500 million in total assets.

**The Cap is a Significant Barrier to Entry:** Finally, it is false that only current MBL credit unions will benefit from an increase in the cap: Thousands of credit unions will benefit from an increase in the cap. That’s because the cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but it also discourages credit unions who would like to enter the business lending market from doing so.

The cap effectively limits entry into the business lending arena on the part of small- and medium-sized credit unions—the vast majority of all credit unions—because the startup costs and requirements, including the need to hire and retain staff with business lending experience, exceed the ability of many credit unions with small portfolios to cover these costs.

Today, the economics of the situation arising from the restrictive 12.25% cap make it very difficult for credit unions with less than \$45 million in assets to be involved in the MBL arena. Indeed, over two-thirds 67% of the nation’s 7,200 credit unions have \$45 million or less in total assets but only 497 credit unions this size (26% of MBL credit unions) are involved in member business lending.

A \$45 million credit union is currently limited to \$5.6 million in member business loans (roughly 25 loans in total using industry loan-size averages). Using conservative estimates<sup>15</sup>, a portfolio this size

<sup>15</sup> Net interest and fee income equal to 3% of invested funds; annual losses equal to 0.50% of outstanding balances; \$88,000 salary and benefit expense for an experienced commercial lender; other operating expenses equal to 1% of outstanding balances.

would generate approximately \$170,000 in income but would generate expenses totaling \$180,000 (approximately \$88,000 for the salary and benefits of an experienced lender, \$28,000 in loan losses and roughly \$56,000 in other operating expenses.) Smaller institutions would incur larger net losses on their portfolios because many of the costs incurred are fixed.

Raising the cap to 27.5% of assets would change the economics significantly – making it possible for credit unions as small as \$20 million to reasonably participate in this market. This would open the market to over 700 additional credit union lenders.

**Banker Claim: Credit unions near the cap should simply redirect their efforts to SBA lending since SBA loans are not subject to the cap.**

**Facts:** At the end of September 2011, there were 359 credit union SBA lenders throughout the nation. Total SBA loans at credit unions have roughly doubled since the start of the financial crisis at the end of 2007.

Excluding grandfathered credit unions and low-income designated credit unions the number of credit union SBA lenders now stands at 270 and the number of credit union SBA lenders has more than doubled since the start of the financial crisis: At the end of 2007 there were 126 credit unions engaged in SBA lending<sup>16</sup>. The growth in SBA loans among these credit unions has been astounding. Since the start of the financial crisis, SBA loans outstanding at these credit unions have grown by 142% - an average of 27% per year.

It is important to note that cap-constrained credit unions typically can't use SBA lending to side-step the 12.25% cap because SBA lending is not a substitute for member business lending. Credit unions that enter into SBA loan relationships with new or existing small businesses find that as those businesses grow and mature they are significantly less likely to need/want/qualify for SBA loans. So ultimately, the credit unions are left with the cap constraints AND the probability that they've spent significant time, effort and other resources to grow a business that then needs to be turned away.

Although SBA lending has been growing quickly credit unions offer some interesting observations concerning why more SBA lending isn't being done. A sampling of opinions:

- “Many of the MBL loans credit unions originate are not eligible for SBA financing. For example, all credit union non-owner-occupied (rental property) loans are considered MBLs and typically such loans are not eligible for SBA. So a credit union lender that does only rental properties as MBLs (in order to offer a full-service mortgage operation) could very well fill up its limit and would find not relief from SBA.”<sup>17</sup>
- “Doing SBA loans is very time consuming and very complicated.”
- “We feel need to hire SBA specialists – our existing staff just doesn't have the expertise to do these right”
- “A lot of ‘nitpicky’ work needs to be done on SBA loans. If any mistake is made it can be very difficult/time consuming to recover a loss.”
- “They require a lot of education and expertise and these requirements are magnified significantly if you originate loans that are complex.”
- “We had a situation where something wasn't filed “just so” and SBA did not want to pay us. We eventually did get paid but it required an enormous amount of staff time to work through the situation.”
- “There are companies that will do the paperwork for you – but that puts you close to a break-even scenario or in the loss-leader category.”

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<sup>16</sup> Excluding grandfathered and low-income credit unions.

<sup>17</sup> MBLs secured by non-owner occupied real estate account for 30% of total credit union MBLs according to NCUA call report data.

- “Many borrowers use SBA as a last resort – they find the paperwork, inflexible requirements and time involved overwhelming. Ultimately, as a consequence, many opt to finance through credit card debt or by other means like borrowing from family members.”
- “Doing SBA loans well can require a significant investment in training and the loan programs themselves can be complex and difficult to administer.”

Of course MBL lenders compare notes and the difficulties and challenges of SBA lending are widely known even among those that are not currently engaged in the program.

Nevertheless the credit union record on SBA lending has been impressive.

**Banker Claim: Raising the cap is undesirable because member business lending is incompatible with credit unions’ statutory mission of serving only consumers.**

**Facts:** Credit unions have been making business loans since their inception in the early 1900’s. In the first 90 years of their existence, there was no business lending cap at credit unions. The current 12.25% of assets cap was an arbitrary limit imposed by Congress in the Credit Union Membership Access Act in 1998 (CUMAA).

The credit union tax exemption arises from their unique structure as not-for-profit, democratically-controlled cooperatives – and that structure is unchanged over the past 100 years. The tax exemption has absolutely nothing to do with the breadth or volume of credit union product and service offerings – a fact clearly spelled-out by Congress in CUMAA.

**Banker Claim: Raising the cap is undesirable because increased member business lending will force credit unions to reduce their lending to consumers.**

**Facts:** The average loan-to-asset ratio at credit unions that offer business loans is 62%. Accounting for the roughly 5% of assets in fixed and other assets, that leaves about 32% of assets in cash and investments. If an additional 12% of assets were eventually devoted to business lending as a result of lifting the cap, credit unions could fund the increase almost exclusively out of investment holdings.<sup>18</sup>

**Banker Claim: Tax-subsidized institutions like credit unions should not be granted expansion of powers – this is especially true now because the credit union tax subsidy is contributing to the national debt during a time of extreme budgetary pressure.**

**Facts:** Having credit unions pay federal income taxes will have no discernible effect on the federal budget deficit. The Joint Committee on Taxation’s current estimate of the value of the credit union tax exemption was \$1.7 billion in 2011, whereas the federal budget deficit was \$1.3 trillion in 2011.<sup>19</sup>

Because credit union taxation would have an indiscernible effect on the deficit it would have no impact on interest rates in the economy. With no effect on interest rates, borrowing, spending, job creation and economic activity would be unaffected. However, credit union small business lending does in fact produce greater capital expenditures, greater economic activity and ultimately more job creation. The multiplier effect means that these new jobs lead to new spending which then sets in motion support to a self-sustaining economic recovery.

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<sup>18</sup> NCUA Call Reports.

<sup>19</sup> Joint Committee on Taxation. Estimates of Federal Tax Expenditures for Fiscal Years 2010 – 2014. December 15, 2010.



Finally, it is worth noting that while bankers claim that tax status ought to prevent credit unions from obtaining more powers, they simultaneously lobby to achieve such expansions among tax-advantaged Subchapter S banking institutions.

**Banker Claim: Raising the cap will harm community banks.**

**Facts:** As of September 2011, credit unions held a total of \$40 billion in loans to small businesses. This represents 5.6% of all small business loans at depository institutions. It took credit unions 100 years to reach this share of market. Even if credit unions were to double their market share in the future that would still leave banks with an overwhelming 88% share.<sup>20</sup>

The Treasury Department has found that credit unions do not have a competitive advantage over banks, and that credit union business lending does not harm community banks. In a 2001 report on credit union business lending, the Treasury Department concludes:

Credit unions have advantages over other depository institutions in that some receive sponsor subsidies, while all are exempt from the federal corporate income tax. However, credit unions do face certain constraints, in the form of limitations on the eligibility to receive such loans and on the loans themselves, that banks and thrifts do not have. Overall, we cannot discern whether credit unions have a competitive advantage.<sup>21</sup>

and,

Overall, credit unions are not a threat to the viability and profitability of other insured depository institutions.<sup>22</sup>

These Treasury conclusions were admittedly based on the existence of a 12.25% cap and a lower level of credit union business lending than pertains today. However, as mentioned above, doubling current credit union business lending would still leave over 90% of the market to banks. Under those circumstances, it is unlikely that Treasury would need to dramatically alter its conclusions.

**Banker Claim: Pursuit of expanded commercial lending powers calls into question the credit union industry's commitment and ability to serve the needs of lower-income and un-banked populations.**

**Facts:** It is true that part of the credit union mission is to serve those of modest means. It also is true that many modest means individuals run small businesses and need credit. This is especially true in economic downturns because unemployed and discouraged job seekers are more likely to form businesses during these events.

Treasury's 2001 comprehensive analysis of credit union business lending showed that credit unions do a very good job of serving the business credit needs of low and moderate income business owners. Treasury found that 25 percent of member business loans were made to members with household income of less than \$30,000 -- and that these loans totaled 13 percent of the outstanding member business lending balances. Another 20 percent of the loans (with 15 percent of the outstanding loan balance) went to households with incomes reported to be between \$30,000 and \$50,000.<sup>23</sup>

Beyond business lending, credit unions do an outstanding job of serving those of modest means. For instance, Home Mortgage Disclosure Act (HMDA) data – the primary data source in CRA

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<sup>20</sup> NCUA Call Reports and FDIC Statistics on Depository Institutions.

<sup>21</sup> United States Department of the Treasury, *Credit Union Member Business Lending*, January 2001. p 5.

<sup>22</sup> *Ibid.* p.5.

<sup>23</sup> *Ibid.* p. 3.

examinations - clearly and consistently show that compared to banks, credit unions make a greater percentage of their loans to lower income individuals. HMDA data also reveal that lower income households are substantially more likely to be approved for loans at credit unions and substantially less likely to be denied a loan at credit unions.

For example, analysis of HMDA data shows that, since 2005, credit unions have approved an average of 67% of applications from low/mod income borrowers, whereas other lenders approved an average of only 55% of these applications. Moreover, since 2005, an average of 26% of total credit union mortgage originations were to low/mod income borrowers while low/mod income originations represented 24% of total originations at other lenders.

It is worth noting that credit unions have repeatedly attempted to reach out to serve more individuals in lower-income households. However, bankers have used the courts to bar those efforts. This tactic of claiming that credit unions are not “doing enough” on the one hand while simultaneously erecting obstacles to the provision of credit union service does nothing to help these communities.

**Banker claim: Credit union lending displaces lending by taxpaying banks. Because of this, it reduces tax revenue to the government and increases the deficit cost to taxpayer.**

**Facts:** There are several flaws associated with this claim. Chief among these are:

1. First, an increase in credit union business lending will not likely lead to an equal reduction in bank business lending for reasons explained below.
2. Even if credit union business lending does crowd out some bank business lending, that would not result in a reduction in bank assets; rather the bank assets would more likely be redeployed from business loans to securities or perhaps other types of loans.
3. Even if increased credit union business lending caused a reduction in bank lending, profits and tax payments, the increased credit union business lending would simultaneously increase tax revenues paid by the small businesses that borrowed from credit unions because credit unions typically charge lower rates on loans than banks do.

Economic theory is revealing on the extent to which credit union lending may or may not “crowd out” bank business lending. Raising the credit union business lending cap is equivalent to an increase in the supply of business credit. Unless the demand for business loans were totally price inelastic, that increase in supply would lead to some increase in loans, i.e., the demand curve is not vertical.

Recently, researchers at the Federal Reserve Board estimated a semi-elasticity of demand for unsecured business loans to be -1.4, implying that a 100 basis point reduction in loan rate would be associated with a 1.4% increase in the amount of loans demanded.<sup>24</sup>

This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using the Federal Reserve’s estimate, and considering that credit unions currently hold on average only about 5% of the small business loans held by depository institutions, and that current versions of legislative language would limit annual business loan growth above the old cap to 30%, if

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<sup>24</sup> Basset, William F., Chosak, Mary Beth, Driscoll, John C., and Egon Zakrajsek (All of the Division of Monetary Affairs, Federal Reserve Board.) “Identifying the Macroeconomic Effects of Bank Lending Supply Shocks.” December 2010. Page 18. Available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1758832](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832).

credit unions entered the market lowering interest rates by roughly 100 bp, the vast majority of that new lending could be accomplished without any reduction in bank loans.

Across the board on virtually all standardized consumer financial products, credit unions typically charge lower rates and fees, or pay higher dividend rates, than do banks.<sup>25</sup> However, because of the variety of types of business loans, and differing terms and conditions available within types, there is no standardized comparative data on bank and credit union business loan pricing.

A small business loan is just not a commodity in the sense that a credit card or five-year new car loan is. Nevertheless, we believe the abundant available evidence on better terms from credit unions on consumer financial products strongly suggests that a business that receives a loan from a credit union is very likely to pay less on average than it would for the equivalent loan from a bank. This would boost small business profits and tax payments.

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<sup>25</sup> See, for example, Informa (a CUNA-endorsed vendor), Datatrac (an ABA-endorsed vendor) and/or Ratewatch interest rate databases.