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TESTIMONY OF
BILL CHENEY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

HEARING ON
"CREDIT UNIONS: MEMBER BUSINESS LENDING"

JUNE 16, 2011

Testimony of
Bill Cheney
President and Chief Executive Officer
Credit Union National Association
Before the
United States Senate
Committee on Banking, Housing and Urban Affairs
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Mr. Chairman, Ranking Member Shelby, Members of the Committee, thank you very much for calling today's hearing on credit union member business lending and giving me the opportunity to testify on behalf of the Credit Union National Association (CUNA)[1]. My name is Bill Cheney and I am CUNA's President and Chief Executive Officer.

Although credit unions generally weathered the crisis well, remaining well capitalized and continuing to lend while other lenders pulled back access to credit, the economy as a whole is struggling to recover from the most significant financial crisis since the Great Depression. Congress and the Administration have taken several steps to address these problems. Unfortunately, unemployment remains very high. Small businesses, many of which saw their credit lines cut off by banks during the financial crisis, struggle to access credit. And, the banks to which Congress pledged $30 billion of taxpayer money as an incentive to lend to small businesses have certainly not embraced that opportunity, leaving two-thirds of this money unclaimed.

[1] CUNA is the nation's largest credit union advocacy organization representing nearly 90% of America's 7,300 state and federally chartered credit unions and their 93 million members.

As everyone agrees, more needs to be done to help America's small businesses. Credit unions can help if Congress enacts S. 509, the Small Business Lending Enhancement Act. This much needed, commonsense legislation would increase the statutory credit union member business lending (MBL) cap from 12.25% of a credit union's total assets to 27.5%, and impose statutory and regulatory safeguards on the increased lending designed to protect the National Credit Union Share Insurance Fund (NCUSIF) from increased risk. These additional safeguards were designed by the Treasury Department and the National Credit Union Administration (NCUA). If this legislation is enacted, we estimate that credit unions could lend an additional $13 billion to their small business-owning members in the first year, helping them to create 140,000 new jobs, without an outlay of a single taxpayer dollar.[2]

My testimony today will discuss: credit union business lending activity since the *Credit Union Membership Access Act* (P.L. 105-219), which imposed a statutory cap on credit union business lending, was enacted in 1998; the need for additional business lending in today's economy; legislation (S. 509 / H.R. 1418) which has been introduced and endorsed by the Administration, to increase the credit union member business

[2] Our estimates are based on the following conservative assumptions: 1) no increase in lending by grandfathered credit unions; 2) in the aggregate, non-MBL lenders increase their loans to 1% of assets under the new authority; 3) all other credit unions lend an amount equal to their current "use rate". Estimates arrived at using these assumptions are further adjusted as follows: a) credit unions with net worth/assets <= 6% are assumed to have no growth; b) credit unions with 6% to 7% net worth remain at the current 12.25% cap; c) credit unions with 10%+ MBL/assets are limited to a 30% increase in the first year. The first-year increase is equal to 40% of the new "use rate". Assumptions for increased employment are based on the Council of Economic Advisors May 2009 *American Recovery and Reinvestment Act* job creation estimates ($92,000 in spending creates one job).

lending cap; the impact of the legislation on federal revenues; and, the objections to this legislation raised by the banking trade associations.

Credit Union Business Lending since the Enactment of the Credit Union Membership Access Act

The number of U.S. credit unions has declined significantly since 1998 – a trend which mirrors the consolidation occurring in the banking industry.[3] One result of the trend to fewer, but larger, institutions is that more credit unions now have the resources to be active business lenders.

At the end of 1998, 1,540 U.S. credit unions – 14% of the nation's 13,000 credit unions – reported member business loans on their balance sheets; member business loans represented only 3% of total loans at offering institutions (or 1% of total credit union loans). Today, 2,200 credit unions – or 30% of all credit unions – report member business loans on their balance sheets. These loans now represent 8% of total loans at offering institutions (or 7% of total credit union loans).[4]

[3] FDIC reports reveal that the number of banking institutions declined by 28% since 1998 - from 10,464 at year-end 1998 to 7,574 at the end of March 2011. NCUA and CUNA data shows that the number of credit unions declined by 34% (from 11,225 at year-end 1998 to 7,423 at the end of March 2011). In both industries, mergers were the primary driver of the decline in number of institutions.

[4] NCUA and CUNA Policy Analysis. It is important to note that these statistics understate the true involvement of credit unions in the business lending arena. The *Federal Credit Union Act* defines "member business loan" to exclude loans "made to a borrower or associated member that has a total of all such extensions of credit in an amount equal to less than $50,000". Thus, credit unions generally do not include loans for business purposes that are under this $50,000 threshold as "member business loans" on their call report filings.

Credit Union Member Business Lending Trends

Year	Number of US CUs	Percent of CUs Offering	Number Offering	Percent of Movement Tot. Loans	Percent of Offering CU Tot. Loans
1998	11,225	13.8	1,543	1.39	3.24
1999	10,862	14.1	1,526	1.48	3.43
2000	10,536	14.6	1,540	1.57	3.49
2001	10,206	15.4	1,575	1.71	3.55
2002	9,898	16.5	1,633	2.08	3.89
2003	9,574	17.5	1,678	2.53	4.57
2004	9,209	18.8	1,728	3.41	5.27
2005	8,877	21.3	1,892	4.09	5.80
2006	8,535	23.2	1,979	4.72	6.30
2007	8,268	25.2	2,083	5.18	6.61
2008	7,965	27.2	2,170	5.74	7.10
2009	7,708	28.7	2,208	6.23	7.61
2010	7,486	30.2	2,261	6.70	8.04
3/11	7,423	29.6	2,197	6.80	8.02

Source: NCUA and CUNA Policy Analysis.

Credit union member business loans have grown significantly in recent years. In fact, total member business loans at credit unions have grown from $3.5 billion in 1998 to $38.7 billion at the end of March 2011 – more than a tenfold increase since the arbitrary 12.25% cap was imposed.[5]

Credit Union Member Business Loan Totals and Growth

Year	$ Amount Outstanding ($ Mil)	Percent Change in MBLs Outstanding	Amount Granted ($ Mil)	Percent Change in MBLs Granted
1998	$3,462	15.9	$1,563	21.6
1999	$4,097	18.3	$1,816	16.2
2000	$4,821	17.7	$2,000	10.1
2001	$5,613	16.4	$2,839	41.9
2002	$7,325	30.5	$4,215	48.5
2003	$9,731	32.9	$6,189	46.8
2004	$14,486	48.9	$8,438	36.3
2005	$19,234	32.8	$9,453	12.0
2006	$23,911	24.3	$11,182	18.3
2007	$27,970	17.0	$12,050	7.8
2008	$33,037	18.1	$13,888	15.3
2009	$36,312	9.9	$11,100	-20.1
2010	$38,500	6.0	$12,436	12.0
3/11	$38,662	1.7	$12,772	10.8

Source: NCUA and CUNA Policy Analysis. 3/11 growth is annualized.

Since 1998, credit union member business loans have grown at an average annual rate of 22% – more than three times faster than the 7% average annual growth rate of all credit union loans over the same period. In addition, credit union business loan growth

[5] Ibid.

has outpaced growth in other areas of the credit union loan portfolio in all but two years since 1998: credit union mortgage loans grew marginally faster than business loans in both 1998 and 2001.[6]

While member business lending has been growing quickly, credit unions remain a small player in the overall business lending market. In 1998, credit union member business loans represented only 0.2% of total depository business loans, a share that grew to 1.4% by March 2011. Of course, the average size of credit union member business loans – $223,000 – is a clear reflection of the fact that these are truly loans to small businesses.[7] If all credit union member business loans outstanding were considered "small business loans," we find that credit unions have only 6% of all small business loans at depository institutions and a substantially smaller presence when non-depository providers are factored into the equation.[8]

The data make it clear: credit unions represent a fast-growing but small presence in the business loan marketplace. Credit unions clearly are not a threat to commercial banking interests.

Credit unions have a long history of engaging in safe and sound business lending – they have been making these loans since their inception in the United States over 100 years ago. And, credit unions have expanded their member business lending portfolios carefully and prudently.

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[6] Ibid.
[7] Excludes loans for business purposes of less than $50,000.
[8] FDIC, NCUA and CUNA Policy Analysis.

Since 1998, credit union member business loan net charge-offs have averaged an incredibly low 0.26%. Of course, business lending is subject to the fluctuations of the business cycle, so the Great Recession saw an increase in both delinquencies and net charge-offs in credit union business loan portfolios. However, in the first quarter 2011, the credit union member business loan net charge-off rate of 1.18% remained lower than the net charge-off rate on credit union consumer loans (1.64%) and was only marginally higher than the net charge-off rate on total credit union loans (1.10%).[9]

Credit union business lending also reflects substantially greater strength than business lending at other financial institutions. Since 1998, credit union member business loan net charge-offs rates have been roughly one-fourth the bank average (0.26% vs. 0.95%). Additionally, in 2010, credit union MBL net charge-offs averaged less than one-half the bank rate (0.74% vs. 1.75%), and in the first quarter of 2011 credit union MBL annualized net charge-offs remained about equal to bank rate (1.18% vs. 1.14%) even though the bank rate declined dramatically in the most recent quarter.[10]

[9] NCUA and CUNA Policy Analysis.
[10] FDIC, NCUA and CUNA Policy Analysis.

Business Loan Asset Quality Comparisons		
	Net Chargeoffs	
	Credit Union MBLs	Commercial Bank Commercial & Industrial Loans
1998	0.08%	0.43%
1999	0.12%	0.57%
2000	0.05%	0.01%
2001	0.10%	1.43%
2002	0.09%	1.76%
2003	0.08%	1.26%
2004	0.10%	0.50%
2005	0.05%	0.27%
2006	0.08%	0.30%
2007	0.09%	0.52%
2008	0.33%	1.01%
2009	0.59%	2.36%
2010	0.74%	1.75%
1st Qtr. 2011	1.18%	1.14%
Avg. since '98	**0.26%**	**0.95%**

Source: FDIC, NCUA, and CUNA E&S. 1st Quarter 2011 results are annualized.

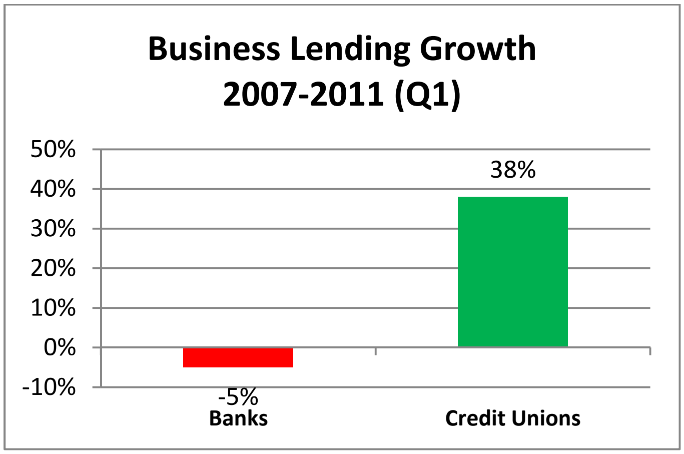
Member business lending at the nation's credit unions has been strong since the enactment of the *Credit Union Membership Access Act*. Since the beginning of the financial crisis, the growth has been nothing short of remarkable. Moreover, credit unions have demonstrated the ability to do this type of lending safely and soundly, especially in comparison to for-profit lenders.

The Need for Reform

Anecdotal evidence – reports we get from our member-credit unions – reveals that small business owners were (and are) being turned away by their banks in large numbers. Those with longstanding relationships with banking institutions have been left without access to capital at a time when they – and the economy – need it most.[11]

[11] Note that the National Federation of Independent Business (NFIB) reports that low sales remain the number-one concern of small businesses. However, throughout 2010, NFIB surveys consistently showed that the percent of small businesses that claimed that they did not have their financing needs met was double the percentage that answered similarly in 2005-2006. The current level of borrowing success remains significantly lower than in the mid-2000s when the NFIB found that up to 90 percent had their credit requests approved.

While other lenders pulled back and hunkered down during the financial crisis, credit unions stepped to the plate and continued to lend to the nation's small businesses. In fact, total credit union business loans increased by 38% since December 2007 while bank business loans decreased by 5% over the same period.[12]



Even today, banks – both large and small – continue to turn away many business borrowers. Bank business loans declined by 4% in the year ending March 2011 and small banks – those with less than $1 billion in assets - saw a decline of 2% during the same period. In contrast, credit union business loans grew by 5% during the period.[13] What these numbers show clearly is that if institutions were willing and able to lend to small businesses during the financial crisis, there was plenty of demand for the loans.

While it is true that member business loans have grown quickly since 1998, it also is true that the strong historical growth rate has been slowing substantially recently. One

[12] FDIC, NCUA and CUNA Policy Analysis.
[13] Ibid.

important reason for this slowdown is that an increasing number of credit unions are approaching the 12.25% statutory cap.

There are now 334 credit unions that are nearing the cap.[14] While they represent just 16% of non-grandfathered credit union business lenders, they account for fully 51% of all business loans subject to the 12.25% cap. They have been the major contributors to credit union member business loan growth over the past few years. In addition, the 144 credit unions that are closest to the cap (those with 10% to 12.5% of assets in member business loans) hold one-quarter of MBLs at non-grandfathered credit unions but have less than $1 billion in unused capacity under the cap. Over the next few years, the growth among these credit unions will dry up without an increase in the cap.[15]

The cap not only restricts the credit unions that are engaging in business lending and approaching their limit, but also discourages credit unions who would like to enter the business lending market. 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 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 68% of the nation's 7,400 credit unions have $45 million or less

[14] Non-grandfathered credit unions with MBL-to-asset ratios greater than 7.5% of assets.
[15] NCUA and CUNA Policy Analysis.

in total assets but only 530 credit unions this size (25% 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, a portfolio this size 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.).[16] 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.

The impact of the credit union member business lending cap on small businesses is seen at credit unions like Listerhill Credit Union in Sheffield, Alabama.[17]

Just a few years ago, Listerhill Credit Union had a member who worked in the barge terminal industry who had an opportunity to operate his own barge terminal in the Port of Florence, AL on the Tennessee River. His request for financing was denied by every bank in town (six of them at least), despite having an outstanding credit score and

[16] 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.
[17] Founded in 1952 by 7 employees of Reynolds Metals plant who started the credit union by depositing $5 each, Listerhill Credit Union has grown to $520 million in assets today by fulfilling its mission of service to its members, including to members who have their own small businesses.

significant experience in the business. He was ultimately referred by a friend to Listerhill Credit Union which granted a loan of around $200,000.

Because of this loan from the credit union, the borrower was able to open a barge terminal in port that does stevedoring (loading and off-loading of barges) and barge maintenance repair. His business has been successful and now employs four other workers. Last year, this small business owner had the opportunity to purchase an additional tugboat to expand and do work offsite. This would have doubled his business and meant hiring an additional three people. Unfortunately, Listerhill Credit Union had to deny his request for the sole reason that it was already against the statutory cap on member business loans. The business owner estimates that the lost opportunity cost him between $200,000 and $250,000 in additional revenue during the recent economic recession.

Listerhill Credit Union currently manages and maintains a member business loan portfolio of near $50 million with no delinquencies and one charged-off member business loan in their history.

Mr. Chairman, credit unions like Listerhill are serving the needs of their business-owning members in every state of the Union. Credit unions have the capital to lend. They have the willingness to lend. They need Congress to let them lend. Allowing credit unions to extend member business loans to those who need credit will add fuel to help create a self-sustaining economic expansion.

S. 509 – The Small Business Lending Enhancement Act

Senators Mark Udall, Olympia Snowe and Charles Schumer, have introduced legislation (S. 509) which, if enacted, would increase the credit union member business lending cap from the current level of 12.25% of total assets to 27.5% of total assets.[18] Similar legislation (H.R. 1418) has been introduced in the House of Representatives by Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY).

The Udall-Snowe-Schumer bill, which the Administration supports, establishes a two-tier structure for the credit union member business lending cap. Tier One credit unions would be eligible to engage in business lending up to the current cap of 12.25% of total assets. Tier Two credit unions would have to meet even more statutory and regulatory criteria and be approved by NCUA, and only then would they be permitted to engage in additional business lending up to 27.5% of total assets. In order for a credit union to be considered for Tier Two status, the credit union would have to:

- be well-capitalized (currently, at least 7% net worth ratio);
- be at or above 80% of the Tier One cap for one year prior to applying for approval;

[18] S. 509 has also been cosponsored by Senators Boxer, Brown (OH), Collins, Franken, Gillibrand, Leahy, Lieberman, Nelson, Reed, Whitehouse, Wyden, Stabenow, Levin, Sanders, Inouye, and Reid.

- have engaged in member business lending for five years prior to applying; and

- be able to demonstrate sound underwriting and servicing based on historical performance; strong management, adequate capacity to lend, and policies to manage increased business lending.

Under S. 509, Tier Two credit unions would be required to phase in additional business lending by limiting a Tier Two credit union's business lending portfolio growth to no more than 30% per year. NCUA would approve a credit union for Tier Two status using statutory standards, set by Congress, not the regulator. Additionally, a credit union that drops below the well-capitalized level would have to stop making new business loans until such time as NCUA determines it is again well-capitalized.

The legislation makes no change to the definition of a business loan, preserving, but not increasing, the current $50,000 *de minimus* threshold. Finally, S. 509 directs NCUA and the Government Accountability Office to conduct separate studies of credit union business lending and report to Congress three years after enactment.

S. 509 would permit credit unions to help small businesses in need of credit while at the same time ensuring that credit unions engaging in additional business lending are continuing to do so safely and soundly. Many of the new features of this proposal address safety and soundness, and will safeguard the NCUSIF against increased exposure.

As noted above, we estimate that if this proposal were enacted into law, credit unions could lend an additional $13 billion to small businesses in the first year after implementation, helping small businesses create as many as 140,000 new jobs. **This is a job creation proposal that would not cost the taxpayers a dime and would not increase the size of government.**

This legislation is not a panacea for the economic problems we face, but it will help small businesses. That is why over twenty small business and public policy groups have signed an open letter urging Congress to enact the Udall-Snowe-Schumer bill including: the Americans for Tax Reform, Competitive Enterprise Institute, Ford Motor Minority Dealer Association, Hardwood Foundation, Freedom Action, AMT – The Association for Manufacturing Technology, League of United Latin American Citizens (LULAC), American Consumer Institute, National Association of Mortgage Brokers, National Cooperative Business Association, National Farmers Union, National Small Business Association, NCB Capital Impact, National Association of Professional Insurance Agents, National Association for the Self-Employed, National Council of Textile Organizations, National Association of Realtors®, Council for Insurance Agents and Brokers, Center on Risk, Regulation and Markets at the Heartland Institute, and the Association for Manufacturing Technology.

Addressing the Congressional Budget Office Score

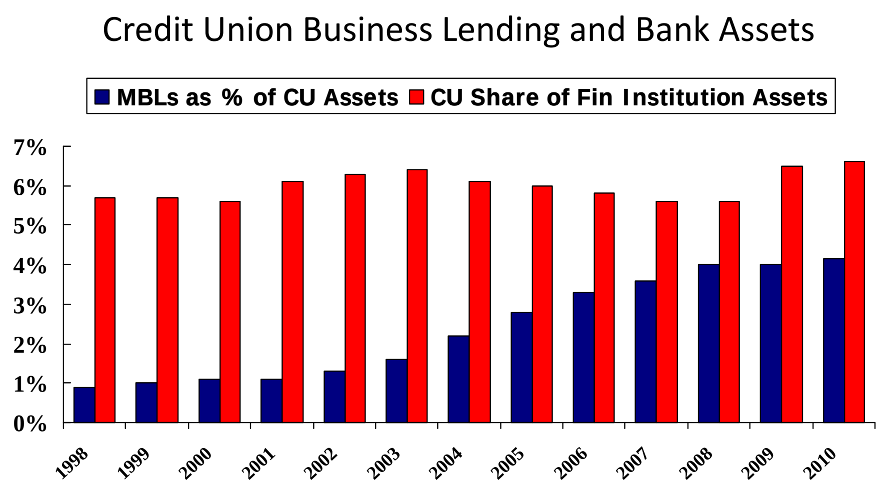
We understand that the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) were asked to score the cost of an identical bill (S. 2919) introduced by Senator Udall in the 111th Congress, and that the estimated revenue losses ranged from $4 million in 2012 to $65 million in 2020. The total of the estimates from 2010 to 2015 is $77 million; from 2010 to 2020 it is $354 million. CBO provided the following explanation for the estimates of the Statutory Pay-As-You-Go Impact:

> S. 2919 would increase the cap on business loans made and held by certain credit unions. As a result, some assets would be shifted from taxable financial institutions to credit unions, which are generally exempt from federal income taxes. The estimate of revenue losses as shown in the table was prepared by staff of the Joint Committee on Taxation.

Based on this explanation, we expect that JCT derived the tax loss estimates on the basis of estimates of or assumptions about the following factors:

- The amount of new business lending that would be undertaken by credit unions through 2020 as a result of lifting the lending cap.
- The amount of that new business lending that would represent a transfer of assets from taxed banks to untaxed credit unions, i.e., replacing bank lending with credit union lending.
- The income banks would have earned on those assets.
- The average effective tax rate paid by banks.

If indeed this is how the analysis was conducted, we offer the following observations. The historical record does not suggest any relationship between the growth of business lending at credit unions and a shifting of assets from banks to credit unions. As the chart below shows, despite a fourfold increase in the proportion of credit union assets held in business loans from 1998 to 2010, the credit union share of the combined assets of credit unions and all banking institutions over the same period has hardly budged, fluctuating in a narrow range around 6%. There are likely two reasons for this phenomenon.



Combined assets include credit unions and all banking institutions (commercial banks and thrifts.)

Sources: FDIC, NCUA , and CUNA Economics and Statistics

First, it is likely the case that many of the business loans made by credit unions would not have otherwise have been made by banks or other taxable lenders. Many of the loans might be too small or non-standard for banks, or the borrowers may not feel comfortable applying to a commercial bank. Therefore, the proportion of banks loans that would be "crowded out" by credit union loans would be easy to overestimate.

Second, given the typical operation of a community bank, the size of the institution is determined less by its loans than by its deposits. Unlike large, money center banks that can readily vary their funding levels by borrowing or issuing negotiable CDs, community banks are largely funded by retail and small business deposits, much of them core deposits. These funding sources are much less controllable by the bank. Typically, large banks arrange whatever liabilities are necessary to fund their available assets whereas community banks instead deploy whatever deposits are available into the most advantageous assets. To the extent credit union business lending – which is typically made up of relatively small loans – does crowd out bank business lending, it would mostly be from smaller banks, which would not actively shrink their assets as a result. The only effect on bank assets would be if some business borrowers transferred some deposits from banks to credit unions. The relevant factor is less the amount of assets transferred from banks to credit unions than it is the amount of bank assets that would be deployed into bank investments in securities rather than in bank loans as a result of reduced business lending. Therefore, estimates of lost tax revenue should be based primarily on the difference between the net rates of return on bank business lending and bank investments, applied to the reduction in business lending. Since the net return on bank investments is likely to be substantially above zero for most of the period of analysis, the reduction in bank taxable income would be much less than that calculated if the bank were assumed to shrink by the amount of the reduced business lending.

Finally, considering only the tax loss from reduced bank profits ignores the simultaneous tax gain to Treasury from businesses that borrow from credit unions instead of banks. Because credit unions typically charge less than banks on loans, a business that borrows from a credit union is likely to pay a lower interest rate than it would at a bank. This increases the taxable income of the business by reducing its deduction for interest expense. We do not have specific data on interest rates on business loans at credit unions compared to banks. However, across the board, credit unions charge lower loan rates, fewer and lower fees, and pay higher rates on deposits than do banks. This is evidenced by the lower return on assets (net income divided by assets) at credit unions compared to banks. The credit union return on assets is typically about a percentage point below that at banks. Assuming about 40% of that goes to savers and 20% comes from lower fees, that leaves around 40 basis points, on average, in lower loan rates. This is part of the cooperative advantage. Therefore, on those new business loans made by credit unions that would otherwise have been made by taxable lenders, the same transaction that reduces the taxable income of the bank increases the taxable income of the borrower (reasonably approximated by a 40 basis point reduction in deductible interest expense).

To the extent any of these factors were not taken into account in JTC's estimate of the tax revenue effects of S. 509, the revenue estimates would be overstated. Once all of these factors are included in the analysis, the overall score for the bill would likely be reduced substantially.

We believe in practice, an increase in the credit union member business lending cap would actually reduce the federal deficit because the new business loans that did not crowd out bank lending would stimulate growth at small businesses, increase employment and incomes, and hence tax revenues.[19]

Only the Bankers Oppose Credit Union Business Lending and Their Objections Do Not Hold Water

[19] The points we raise above ignore these dynamic effects, instead complying strictly with the "fixed GNP constraint."

The Udall-Snowe-Schumer bill attempts to address a very significant public policy problem – the difficulty small businesses are having accessing capital – without increasing risk exposure to the federal government and without outlaying a penny of taxpayer money.

As Senator Udall has said, “It is hard for me to believe that the government is telling [credit unions] they cannot help create jobs in their local communities.”[20]

It is hard for small businesses, credit union employees and volunteers to believe as well. And when they ask me why Congress will not let credit unions do more business lending, there is truly just one answer.

The banks oppose it.

That answer is not good enough for taxpayers who have given the banks $30 billion of their money to lend to small businesses, but have only seen the banks use $9.2 billion (64% of which was requested by TARP recipients).[21] It does not satisfy the small business owner who has been turned down for a loan by multiple banks; it should not satisfy Congress. It should satisfy no one.

There are a lot of reasons to let credit unions do more small business lending – at least 140,000. But there are no sound public policy reasons not to. Failure to expand the credit union member business lending cap would literally leave money on the table that could be loaned to small business.

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[20] Statement of Senator Mark Udall. *Congressional Record*. March 17, 2001. S1785
[21] Office of the Inspector General. Department of Treasury. “Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund.” May 13, 2001. 2,7.

The bankers raise a number of objections, but none of them hold water.

The bankers say business lending is not a part of the credit union mission. The facts show that credit unions have been doing business lending since day one.

The earliest credit unions were founded so that people could borrow money to buy goods at lower cost and sell them for a profit. The founders of the American credit union movement very specifically noted the important role credit unions should play in providing access to credit for small businesses. As Alphonse Desjardin said in 1908, as he encouraged the founding fathers of St. Mary's Bank Credit Union to organize the United States' first credit union:

> "There are not only the manual laborers, whether of industry or of the land, who need credit and who, very often, are forced to suffer the extortions of the Shylocks of usury: There is also a very interesting class of small merchants, of humble industrialists, of modest entrepreneurs whose financial status does not permit them to have access to the large banks where their well enough known fellow businessmen go to stock up in order to enjoy the benefit of a checking account. To all of them as well, the cooperative offers financial assistance that is most precious."[22]

For the first 90 years of credit unions' existence in the United States, there was no statutory business lending cap for credit unions. Serving the business borrowing needs of credit union members is not only a part of the credit union mission, it is part of the credit union DNA. Congress imposed a statutory cap on credit union member business lending in 1998 at the behest of the banking industry which opposed the *Credit Union Membership Access Act of 1998*. However, the Clinton Administration said that there

[22] *L'Avenir National* (Manchester, N.H.), Vol. XXI, No. 67, 28 November 1908, p. 4-5.

was no economic or safety and soundness rationale for restricting credit union business lending by statute.

> "The Administration sees no safety and soundness basis for an amendment that would limit the ability of credit unions to make business loans to their members. Existing safeguards, coupled with the new capital and other reforms in the bill, are sufficient to protect against any safety and soundness risk from member business loans."[23]

The bankers say increased business lending would undermine credit union safety and soundness.

As we have noted above, the facts show that credit unions do this type of lending more safely and soundly than the banks; the credit union net charge-off rate has been roughly one-fourth the bank average since 1998.

Furthermore, 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, importantly, overall safety and soundness.

Credit unions are committed to operating in a safe and sound manner, which is why we sought the guidance of the Department of Treasury and the NCUA in developing legislation to increase the credit union member business lending cap in a manner that does not jeopardize credit union safety and soundness. We believe it is very significant that the Udall-Snowe-Schumer bill mirrors a proposal put forward by the Secretary of

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[23] Statement of Administration Policy. H.R. 1151 (105th Congress). July 22, 1998.

Treasury to raise the credit union business lending cap and includes additional safeguards that not only protect the taxpayer, but also all credit unions which jointly fund the National Credit Union Share Insurance Fund.[24]

The bankers say increasing the cap will only affect a small number of credit unions while at the same time claiming that increasing the cap will hurt community banks.

It is a contradiction – and the bankers are wrong on both counts.

The member business lending cap affects every credit union that has a member who looks to them for financing a new or existing small business. Some have active business lending programs; others do not engage in business lending because they view the cap an impediment that does not justify the sizeable up-front investment necessary provide a sound business lending program in the first place.

As noted above, member business loans have been the fastest growing component of credit union lending every year since 2001. That growth in credit union member business loans is now slowing as more and more credit unions approach their caps. The credit unions that are now near the cap account for over half of the business loans subject to the cap. Having been there for their small business-owning members over the last several years, these credit unions will see their ability to continue this service diminish in the absence of Congressional action to increase the business lending cap.

[24] A copy of Secretary Geithner's letter regarding this proposal is attached to this testimony.

Increasing the cap will have a profound effect on the hundreds of credit unions that will reach the cap in the next few years, but it will not adversely affect the banker dominance of the market for small commercial loans – currently at 94%. In fact, credit union member business lending actually helps local communities, including community banks, by stabilizing the local economy and creating jobs.

Economic theory is revealing as to whether 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.[25] This suggests that an increase in credit union lending would not substantially come from reduced bank loans. Using the Fed estimate, and considering that credit unions currently hold on average only about 6% of the small business loans held by depository institutions, and that S. 509 would limit annual business loan growth above the old cap to 30%, if credit unions entered the market lowering interest rates by roughly one percentage point, the lion's share of that new lending could be accomplished without any reduction in bank loans.

[25] 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. 18. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1758832.

The bankers say that increased credit union business lending will lead to a reduction of other types of credit union lending.

Increasing the cap – rather than removing the cap – guarantees that the increases in member business lending would be accomplished while credit unions remain primarily focused on consumer lending. The average loan-to-asset ratio at credit unions that offer business loans is 60%. Accounting for the roughly 5% of assets in fixed and other assets, that leaves about 35% of assets in cash and investments. If the member business lending cap was to be increased, and an additional 15.25% of assets were eventually devoted to business lending, credit unions could fund the increase almost exclusively out of investment holdings, while still maintaining plenty of liquidity.

The bankers say that credit unions should not be granted an expansion of powers because of their tax status.

This specious and sidetracking argument ignores the fact that roughly 2,500 banks are Subchapter S institutions, and, like credit unions, have been afforded special federal income tax treatment by Congress. It is more than a little disingenuous for the bankers to use the credit union tax status as an argument against increasing the credit union member business lending cap when one-third of all banks as Subchapter S corporations are exempt from federal income tax; the bankers recently received a $30 billion subsidy of their business lending activities; credit unions have not cost the taxpayer a dime; credit unions fund their own share insurance fund; and, no credit union member has ever lost a dollar of insured deposits in a federally insured credit union.

Unfortunately, the bankers' correlation of the tax status and the member business lending cap reveals not only their hypocrisy but also their willful misrepresentation and ignorance of the credit union tax status. The credit union tax status, which has been reaffirmed by Congress several times, is based on the structure of credit unions as not-for-profit, democratically-controlled cooperatives. That structure has not changed for the past 100 years. The tax status has nothing to do with the breadth or volume of credit union products or service offerings.

The bankers say that increased business lending will distract credit unions from serving the underserved and call into question the credit union industry's commitment and ability to serve the needs of lower-income and un-banked populations.

In this country, there are many who are underserved, and the credit union record on serving the underserved is well demonstrated. Home Mortgage Disclosure Act (HMDA) data clearly and consistently show that compared to banks, credit unions make a greater percentage of their loans to lower income individuals and that lower income households are much more likely to be approved for loans at credit unions while much less likely to be denied a loan at credit unions. 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. The banker tactic of claiming that credit unions are not "doing enough", while erecting obstacles to the provision of credit unions' service, does nothing to help these communities.

As we recover from the Great Recession, *small businesses are underserved*. Bank business lending portfolios have shrunk while credit unions' have increased. Many modest means individuals run small businesses and need credit. This is especially true in recessions because unemployed and discouraged jobseekers are more likely to form businesses during these events. Credit unions want to meet the needs of their business-owning members, and the last Treasury study on credit union member business lending found that credit union loans to small businesses go disproportionately to business owners on the lower end of the income scale.[26]

The bankers say that there is no evidence to support the contention that credit for small business is in short supply and that community banks have been lending throughout the crisis.

As noted above, small business surveys have indicated that more small businesses indicate their financing needs are not being met than in 2005-2006 and borrower approvals remain significantly lower than when nine out of ten borrowers had their credit requests approved. Additionally, many small business owners are telling policymakers that they are being turned away by their banks – a primary reason that Congress gave the banks access to $30 billion taxpayer dollars last year. Banks – both large and small – have turned away many business borrowers during the crisis, despite significant demand for capital. As noted, from December 2007 through March 2011, total bank business lending declined by 5% while credit union business lending increased by 38%. Allowing credit unions to extend member business loans to those who need credit will add fuel to a self-sustaining economic expansion.

[26] United States Department of the Treasury, *Credit Union Member Business Lending,* January 2001. 3.

The time is now to set expose the bankers' arguments for what they are -- groundless rhetoric. We urge Congress to permit credit unions to do what they were established to do – serve their members, including those who own small businesses. We have the willingness to help. We have the capacity to help. But, we need Congress to act.

Mr. Chairman, thank you very much for the opportunity to testify today. I am happy to answer any questions the members of the Committee may have.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

May 25, 2010

The Honorable Barney Frank
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Frank:

This letter responds to your request for the views of the Treasury Department concerning current limits on the total amount a credit union can loan in the form of business loans to credit union members. In general, credit unions may make member business loans within a current statutory limit: loans cannot exceed the lesser of 1.75 times the credit union's net worth or 12.25 percent of its total assets. Various proposals have been made to allow for additional lending, such as to raise the limit to 25 percent of total assets with no net worth ratio, as well as to redefine the type of loans that count toward the limit, effectively raising the overall amount of loans even further.

As you know, Representative Kanjorski introduced the *Promoting Lending to America's Small Businesses Act of 2009* (H.R. 3380) and a companion bill has been introduced in the Senate by Senator Udall and others.

The Treasury Department could support proposals to increase credit union member business lending provided safety and soundness concerns are addressed. It is important that reforms are not done in a way that inappropriately introduces more risk to credit union members, the credit union system, the National Credit Union Share Insurance Fund, or the financial system as a whole. Treasury will work with the Congress on legislative proposals that include sufficient safeguards.

One approach would be to maintain the current limit for most credit unions but increase the limit for credit unions that meet certain high standards. In particular, the cap could be raised for credit unions that: (1) have been near the current limit for four consecutive quarters (for example, credit unions with member business loans totaling eighty percent of the amount allowed); (2) are well capitalized; (3) have no less than five years of experience of underwriting and servicing member business loans; (4) have strong policies and experience in managing member business loans; and, (5) satisfy other standards established by the National Credit Union Administration (NCUA) to maintain the safety and soundness of credit unions.

We would support allowing credit unions that meet these high standards to increase lending above the current limit, but the new limit should be no higher than 27.5 percent of total assets. In addition, safeguards should be in place that safeguard against eligible credit unions increasing their member business loans too quickly. We would suggest that member business loan growth for eligible credit unions be limited to no more than thirty percent annually. In addition, the NCUA should be given the authority to set rules creating intermediate member business loan limits and to require approval before any credit union can move to the next higher limit.

Moreover, if a credit union should become less than well capitalized, it should be required to cease member business lending and only resume such lending upon its return to a well capitalized position after regulatory approval. Finally, the NCUA should be vigilant and carefully oversee implementation and there should be reporting on member business lending activity and loan performance. Legislative language is enclosed which reflects this approach and addresses safety and soundness concerns.

We are willing to continue to work with the Congress on legislation that would meet these objectives.

Sincerely,

Timothy F. Geithner

Timothy F. Geithner

Enclosure

SECTION 1. SHORT TITLE.

This Act may be cited as the ''Increased Options for Small Business Lending Act of 2010''.

SEC. 2. LIMITS ON MEMBER BUSINESS LOANS.

(a) REVISED LIMITATION AND CRITERIA.—Effective 6 months after the date of enactment of this Act, section 107A(a) of the Federal Credit Union Act (12 U.S.C. 1757a(a)) is amended to read as follows:

''(a) LIMITATION.—

''(1) IN GENERAL.—No insured credit union may make any member business loan that would result in the total amount of such loans outstanding at that credit union at any one time equal to more than the lesser of 1.75 times the actual net worth of the credit union or 12.25 percent of the total assets of the credit union, except as provided in paragraph (2).

''(2) ADDITIONAL AUTHORITY.—The Board may approve an application of a credit union upon a finding that the credit union meets the criteria under this paragraph to make one or more member business loans that would result in a total amount of such outstanding loans at any one time of not more than 27.5 percent of the total assets of the credit union, only if the credit union—

''(A) had member business loans outstanding at the end of each of the 4 consecutive quarters immediately preceding the date of its application, in a total amount of not less than 80 percent of its applicable limitation under paragraph (1);

''(B) is well capitalized, as defined in section 216(c)(1)(A);

''(C) can demonstrate at least 5 years of experience of sound underwriting and servicing of member business loans;

''(D) has the requisite policies and experience in managing member business loans; and

"(E) has satisfied other standards that the Board determines are necessary to maintain the safety and soundness of the insured credit union.''.

(b) CREDIT UNIONS THAT ARE NO LONGER WELL CAPITALIZED.—Effective 6 months after the date of enactment of this Act, section 107A of the Federal Credit Union Act (12 U.S.C. 1757a) is amended by adding at the end the following:

''(f) EFFECT OF NOT BEING WELL-CAPITALIZED.—

Notwithstanding subsection (a), an insured credit union that has made member business loans under the limitation in subsection (a)(2) and that is not, as of its most recent quarterly call report, well capitalized (as defined in section 216(c)(1)(A)), shall not make any new member business loans, until such time as the credit union becomes well capitalized, as reflected in a subsequent quarterly call report, and obtains approval from the Board.''.

SEC. 3. IMPLEMENTATION.

(a) TIERED APPROVAL PROCESS.—The National Credit Union Administration Board shall develop a tiered approval process, whereby federally insured credit unions gradually increase the amount of member business lending in a manner that is consistent with safe and sound operations, subject to the limit established under section 107 A(a)(2) of the Federal Credit Union Act (as amended by this Act), provided that such rate of increase shall not exceed 30 percent per year.

(b) RULEMAKING REQUIRED.—The National Credit Union Administration Board shall issue proposed rules, not later than 6 months after the date of enactment of this Act, to establish the tiered approval process required by subsection (a). The tiered approval process shall establish standards which seek to ensure that the new business lending capacity provided by section 2 is being used only by federally insured credit unions that are well-managed and well-capitalized, as required by the amendments made by section 2, and as defined in such rules by the National Credit Union Administration Board, consistent with the safety and soundness thereof.

(c) CONSIDERATIONS.—In issuing rules required by this section, the National Credit Union Administration Board shall consider—

(1) the experience level of the institutions, including a demonstrated history of sound member business lending;

(2) the criteria under section 107 A(a)(2) of the Federal Credit Union Act, as amended by this Act; and

(3) such other factors as the Board may deem necessary or appropriate.

SEC. 4. REPORTS TO CONGRESS ON MEMBER BUSINESS LENDING.

(a) REPORT OF THE BOARD.—

(1) IN GENERAL.—Not later than 3 years after the date of enactment of this Act, the National Credit Union Administration Board shall submit a report to Congress on member business lending by federally insured credit unions.

(2) REPORT.—The report required by paragraph (1) shall include—

(A) the types and asset size of credit unions making member business loans and their applicable member business loan limitations;

(B) the overall amount and average size of member business loans by each credit union;

(C) the ratio of member business loans to total assets and net worth;

(D) the performance of the member business loans, including delinquencies and net charge offs;

(E) the effect of this Act on the number of credit unions engaged in member business lending, any change in the amount of member business lending, and the extent to which any increase is attributed to the change in the limitation in section 107A(a) of the Federal Credit Union Act, as amended by this Act;

(F) the number, types, and asset size of credit unions that were denied or approved by the Board for increased member business loans under section 107A(a)(2), as amended by this Act, including denials and approvals under the tiered approval process;

(G) the types and sizes of businesses that receive member business loans, the duration of their credit union membership at the time of the loan, the types of collateral used to secure member business loans, and the income level of members receiving member business loans; and

(H) the effect of any increases in member business loans on the risk to the National Credit Union Share Insurance Fund and the assessments on insured credit unions.

(b) GAO STUDY AND REPORT.—

(1) STUDY.—The Comptroller General of the United States shall conduct a study on the status of member business lending by federally insured credit unions, including—

(A) trends in such lending;

(B) types and amounts of member business loans;

(C) the effectiveness of this Act in enhancing small business lending;

(D) recommendations for legislative action, if any, with respect to such lending; and

(E) any other information that the Comptroller General considers relevant with respect to such lending.

(2) REPORT.—Not later than 3 years after the date of enactment of this Act, the Comptroller General shall submit a report to Congress on the study required by paragraph (1).