CUNA's Response to Objections to Raising the CU MBL Cap

CUNA Research and Policy Analysis - October 18, 2012

Background:

- Total CU MBLs = $42 billion
- CU Share of depository institution small business loans = 6%
- Average Size of CU MBL Outstanding = $217,214

Removing the Cap:

Up to $14 billion additional MBLs in first year
157,000 new jobs in the first year

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 0.25%, a figure that is roughly **one-fourth** the 0.89% bank average over the same period.
- 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 six months ended June 2012, credit unions charged off commercial business loans at a 0.55% rate – identical to the rate reported by banks over the same period.
- 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.
- 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."

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.

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:

- 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.
- 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.
- 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 2002 to June 2012, business loans at credit unions grew at an annual rate of 21.1%, over three times faster than the 5.8% annual growth rate of all credit union loans.
- Thousands - not a small handful - of credit unions are impacted by the cap because the cap as an artificial barrier to entry discourages thousands of non-MBL credit unions from entering the business lending market.

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.

- The Pepperdine Capital Markets Project recently reported that among a sample of 5,500 US small business owners surveyed, 57% of those that sought bank financing said they were not successful in obtaining financing.
- A recent poll commissioned by the American Sustainable Business Council, the Main Street Alliance and the Small Business Majority found 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.
- In the year ended June 2012, community bank commercial loans outstanding grow modestly at 2.6% according to FDIC call report filings, while credit union business loans increased by 6.0% over the same period.

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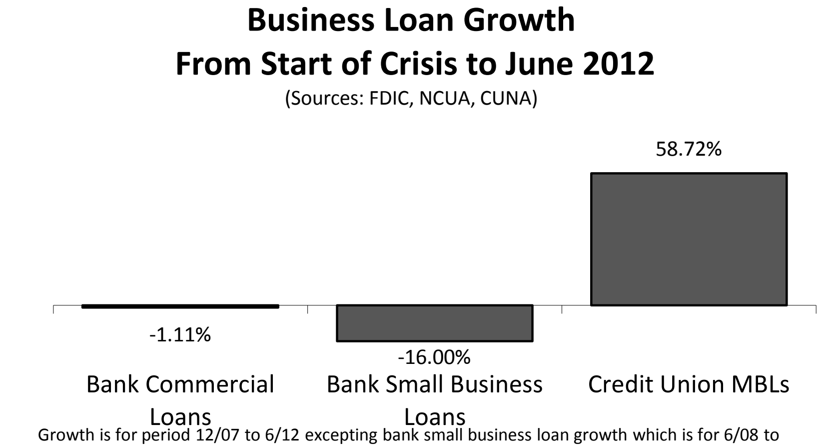
- If indeed the contraction in business credit outstanding were due solely to reduced demand, credit union lending would have declined as it did at banks, rather than registering a 59% increase in the December 2007 to June 2012 period. Again it is important to note that credit union growth has slowed recently as an increasing number of credit unions have begun to approach their caps.



Growth is for period 12/07 to 6/12 excepting bank small business loan growth which is for 6/08 to 6/12. Prior to 2010 banks reported small business loans outstanding only at mid-year.

<u>Banker claim</u>: 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.

<u>Facts</u>: 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. 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 credit unions entered the market lowering interest rates by roughly 100 bps, the vast majority of that new lending could be accomplished without any reduction in bank loans.

<u>Banker Claim:</u> MBLs are incompatible with CUs' statutory mission of serving only consumers.

<u>Facts:</u> CUs 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 CUs. The current 12.25% of assets cap was an arbitrary limit imposed by Congress in the CU Membership Access Act in 1998 (CUMAA). The CU 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 CU product and service offerings – a fact clearly spelled-out by Congress in CUMAA.

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

<u>Facts:</u> 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 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.

Banker Claim: Tax-subsidized institutions like CUs should not be granted expansion of powers – especially now –tax subsidies contribute to the national debt during a time of extreme budgetary pressure.

<u>Facts:</u> Having CUs pay federal income taxes will have no discernable effect on the federal budget deficit. The Joint Committee on Taxation's current estimate of the 2011 value of the CU tax exemption is $400 million – 0.03% of the year's $1.3 trillion federal budget deficit.

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

Facts: 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 CU business lending showed that CUs do a very good job of serving the business credit needs of low and moderate income business owners. Treasury found that 25 percent of MBLs 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.

<u>Banker claim</u>: NCUA has essentially solved the credit union MBL issue by inviting 1,000 eligible federal credit unions to adopt "low income" designations. Credit unions with low income designations are not subject to the MBL cap.

<u>Facts</u>: Of the 503 credit unions in various stages of being affected by the cap (i.e., those feeling initial effects, nearing the cap, or at the cap; aka 5 to 7.5%, 7.5% to 10% and over 10%, excluding grandfathered credit unions), a maximum of only 34 could get needed near term relief because of the LICU designation. In terms of CUNA's estimate of the number of new jobs and additional lending that likely would be done if the cap were increased to 27.5%. Recall that CUNA estimates that raising the 12.25% cap to 27.5% would produce a conservatively-estimated first-year increase of $14 billion in loans and 157,000 jobs nationally.