Thousands of Small CUs Restrained by Arbitrary MBL Cap

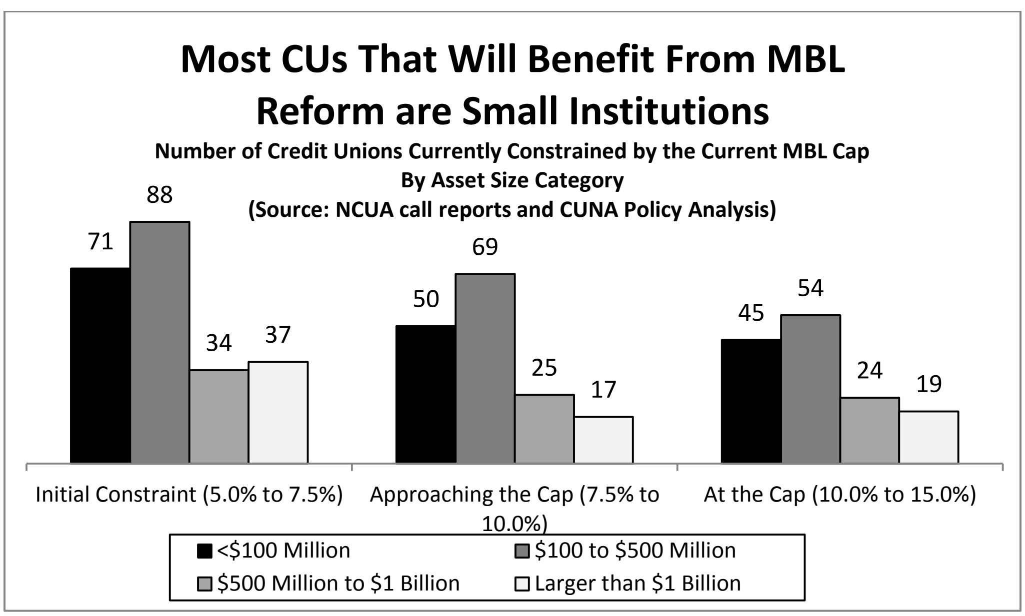
In a recent letter to Congress, the ABA and ICBA make several bizarre claims in arguing against an increase in the credit union MBL cap. For example, ABA/ICBA claims that a cap increase is unnecessary because “only 29 credit unions out of nearly 7,200 are at or near the statutory limit”. They further state that the “primary beneficiaries of expanded business lending authority are just a handful of the largest most aggressive credit unions…”

Both statements are patently false.

In fact, 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[1]:

1. **<u>More than 500 credit unions are or will be bumping up against the cap in the next several years.</u>** 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.

2. **<u>Nearly 90% of all credit unions constrained by the cap are smaller institutions with less than $1 billion in total assets[2] and nearly three-quarters of these constrained credit unions have less than $500 million in total assets.</u>** 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.



[1] NCUA call reports and CUNA Policy Analysis.

[2] 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. Federal banking regulators today define “small” institutions as banking institutions with $1.16 billion or less 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.) Over the past decade, business loans at credit unions grew at an annual rate of 22%, over three times faster than the 6% annual growth rate of all credit union loans. That growth is now slowing as more and more credit unions approach their caps. The closer a credit union gets to its cap, the less accommodative it can be in granting business loans.

The notion that the cap affects only a small number of credit unions 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.

<u>Constraints on Current MBL CUs</u>

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:

MBL Credit Union Profile
Data as of September 2011. Excluding Non-Grandfathered and Low Income CUs
Sources: NCUA and CUNA.

MBLs/Assets	# of CUs	Percent of These CUs with < $500 Mil. in Assets	Total MBLs (Billions)	Percent of Total Non-Grandfathered MBLs	Growth in MBLs in Year Ending June 2011	Estimated Average Number of Years to Reach Cap at Recent Growth Rates
>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
Totals	**1,836**	**82%**	**$28.58**	**100.0%**	**7.2%**	

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.**

MBL Credit Unions: Distribution Changes
Data as of June. Excluding Non-Grandfathered CUs.
Sources: NCUA and CUNA.

MBLs/Assets	Percent of Total Non-Grandfathered MBL Credit Unions				Percent of Total Non-Grandfathered MBLs		
	2001	2006	2011		2001	2006	2011
>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.

<u>The Cap is a Significant Barrier to Entry</u>

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[3], 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.) 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.

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[3] 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.