



# **CUNA & Affiliates**

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**WRITTEN TESTIMONY**

**OF**

**FRANK MICHAEL  
PRESIDENT AND CEO  
ALLIED CREDIT UNION  
ON BEHALF OF THE  
CREDIT UNION NATIONAL ASSOCIATION**

**BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS  
UNITED STATES SENATE**

**“The Effects of the Economic Crisis on Community Banks and Credit Unions  
in Rural Communities”**

**JULY 8, 2009**

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Chairman Johnson, Ranking Member Crapo, and Members of the Financial Institutions Subcommittee, thank you very much for the opportunity to testify at today’s hearing on “The Effects of the Economic Crisis on Community Banks and Credit Unions in Rural Communities” on behalf of the Credit Union National Association (CUNA). CUNA is the nation’s largest credit union advocacy organization, representing over 90% of our nation’s approximately 8,000 state and federal credit unions, their State credit union leagues, and their 92 million members.

My name is Frank Michael, and I am President and CEO of Allied Credit Union in Stockton, California. Allied Credit Union is a small institution with \$20 million in assets and approximately 2,600 member-owners.

Originally my credit union’s field of membership was limited to Greyhound bus drivers but it has grown to include employees served by a variety of labor union locals, those who live, work, worship, or attend school in the incorporated and unincorporated areas of Stockton, California and employees of a number of companies outside of Stockton proper.

I also serve as Chair of CUNA’s Small Credit Union Committee – which is charged with monitoring issues affecting small credit unions that operate in both urban and rural settings.

I am honored to be here to speak to you about the present state of small credit unions in rural communities, the obstacles these institutions are encountering, and the effects of recent legislation on these institutions.

### **Credit Unions Stand Apart from Other Financial Institutions**

I would like to emphasize that while I am here to represent the views of “small” credit unions, credit unions are generally very small by banking industry standards: The average credit union has roughly \$110 million in total assets whereas the average banking institution is fifteen times larger with \$1.7 BILLION in total assets.<sup>1</sup> (The median size credit union has just \$15 million in total assets and the median size bank is about ten times larger with \$146 million in total assets).

It is also important to stress that credit unions – rural, urban, large and small - did not contribute to the sub-prime meltdown or the subsequent credit market crisis.

Credit unions are careful lenders. And, as not-for-profit membership cooperatives the overriding operating objective at credit unions is to maximize member service. Incentives at credit unions are aligned in a way that ensures little or no harm is done to the member-owners. As we have seen, the incentives outside of the credit union sector are aligned in a way that can (and often does) cause harm to consumers. In the case of toxic mortgages such as sub-prime mortgages, entities operating outside of the cooperative sector focused on maximizing loan originations (specifically fee income from those originations) even though many of the loans originated were not in the borrower’s best interest.

Further, credit unions hold most of their loans in portfolio. In recent years, 70% of credit union mortgage originations have been held in portfolio – only 30% have been sold into the secondary market. In the broader credit union loan portfolio the percentage held is even higher. The maintenance of this ownership interest means that credit unions care deeply about what ultimately happens to the loans they originate – they care if the loans are paid back. The sub-prime crisis, in contrast, has been closely linked to lenders who adopted the originate-to-sell model. These lenders cared little about repayments because the quality of the loans they sold became someone else’s problem.

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<sup>1</sup> Financial data is as of March 2009. Credit union data is from the NCUA, bank data is from the FDIC.

In the end these structural and operational differences translated into high asset quality at credit unions.<sup>2</sup> Annualized first quarter 2009 net charge-offs at credit unions were equal to 1.11% of average loans outstanding. In the same period, banking industry net charge-offs were 1.94%.

Delinquency rates – a forward-looking indicator of credit quality also highlights the credit union difference. As of March 2009, 60+ day dollar delinquency rates on credit union loans were 1.44%. In contrast the banking industry's 90+ day dollar delinquency rate was 3.88% - over two-and-one-half times higher than the credit union norm despite an additional 30 days of collection efforts. High asset quality helped to keep credit union capital ratios near record levels. At the end of March 2009 the aggregate credit union net worth ratio was 10% - substantially higher than the 7% regulatory standard that institutions need to be considered "well capitalized".

Strong asset quality and high capital kept most credit unions "in the game" while the other lenders pulled back and significantly tightened loan underwriting standards. Overall, loan growth rates at credit unions have remained comparatively high. In the year ending March 2009, credit union loans grew by 6% - a rate of increase that is well above the 2% to 3% growth credit unions usually see in consumer-led recessions and a stark contrast to the 3% decline in bank loans over the same timeframe.

Real estate loans at credit unions grew by nearly 9% in the year ending March 2009, while banking industry real estate loans declined by approximately 2%. Business loans at credit unions grew by nearly 16% in the year ending March 2009, whereas commercial loans at banking institutions declined by 3%.

Importantly, credit union pricing continues to reflect a strong, long-standing consumer-friendly orientation. According to Datatrac, a national financial institution market research company, credit union average loan rates have remained far lower than those in the banking arena and credit union average yields on savings accounts have remained far higher than those in the banking arena. The pricing advantage to credit union members is evident on nearly every account that

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<sup>2</sup> High credit union asset quality is doubly impressive given the exemplary record of credit union success in serving those of modest means. For example, credit union mortgage loan delinquency and chargeoff rates are very low compared to other lenders. At the same time Home Mortgage Disclosure Act (HMDA) statistics consistently show that lower income and minority borrowers in the market for mortgages are substantially more likely to be approved for a loan at a credit union. HMDA data also shows that compared to other lenders, a greater percentage of total credit union home loans are granted to low/moderate income consumers.

Datatrak measures. In the aggregate, CUNA economists estimate that the credit union pricing advantage saved credit union members \$9.25 billion in 2008 alone.<sup>3</sup> This makes a significant difference to tens of millions of financially stressed consumers throughout the nation.

While credit unions have generally fared well, they are not immune from the effects of the financial crisis. Of course, the “Too Big to Fail” issue roils many small credit unions, including those operating in rural areas. In addition, there are some natural person credit unions, especially in states such as California, Florida, Arizona, Nevada and Michigan that are experiencing serious financial stresses, including net worth strains, primarily as a result of the collateral effects of their local economic environments.

Within the credit union system, the corporate credit union network has been particularly hard hit as credit market dislocations saddled several of these institutions with accounting losses on mortgage-backed and asset-backed securities.

There are currently 28 corporate credit unions, which are owned by their natural person credit union members. Corporate credit unions are wholesale financial institutions that provide settlement, payment, liquidity, and investment services to their members. The powers of corporate credit unions differ from natural person credit unions. For example, the mortgage backed and asset backed securities that are permissible investments for corporate credit unions and not generally permissible for natural person credit unions.

For the most part, the problematic securities were triple-A rated at the time the corporate credit unions purchased them. However, as a result of the impact of the economy on the securities, and the mortgages and other assets underlying the securities, the National Credit Union Administration (NCUA) has projected substantial credit losses relating to these securities.

The recently enacted, “Helping Families Save their Homes Act of 2009” gave NCUA additional tools with which to assist credit unions in dealing with costs related to Corporate Credit Union stabilization actions. We applaud the Banking Committee’s leadership on that issue, and thank

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<sup>3</sup> This estimate does not include the pro-competitive effects credit union pricing has on banking institutions. Several recent studies indicate that the credit union presence causes other institutions to price in a more consumer-friendly fashion, saving consumers several billions of dollars annually. See Feinberg (2004) and Tokel (2005).

Congress for acting expeditiously to address these concerns. These stabilization efforts permit credit unions to continue to provide high levels of membership service while reducing the immediate financial impact on credit unions and ensuring the maintenance of a safe and strong Nation Credit Union Share Insurance Fund.

### **Rural Credit Unions are Playing a Vital Role in the Economic Recovery**

Rural credit unions are unique in many respects.<sup>4</sup> There are nearly 1,500 U.S. credit unions with a total of \$60 billion in assets headquartered in rural areas. These institutions represent 19% of total credit unions and 7% of total U.S. credit union assets.

Rural credit unions tend to be small – even by credit union standards. On average, rural credit unions have just \$39 million in total assets (making them about one-third the size of the average U.S. credit union and **one-fortieth** the size of the average U.S. banking institution.)

In addition, nearly one quarter (23%) of rural credit unions operate with one or fewer full-time equivalent employee. Over half (54%) of rural credit unions are staffed by five or fewer full-time equivalent employees.

These differences mean that even in good times, rural credit unions tend to face challenges in a way that larger credit unions do not. Pressures on the leaders of these small credit unions are great because they must be intimately involved in all aspects of credit union operations. Their small size, without the benefits of economies of scale, magnifies the challenges they face. Competitive pressures from large multi-state banks and non-traditional financial services providers each increasingly provide substantial challenges. Greater regulatory burdens, growing member sophistication, loss of sponsors, and difficulties in obtaining training and education also loom large for most of the nation’s small credit unions.

A bad economy can make things even worse. Small credit unions have very close relationships with their members. And member needs increase dramatically during recessions: They

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<sup>4</sup> For purposes of this analysis “rural” areas are defined as non-MSA counties, consistent with OMB definitions. This definition includes 64% of U.S. counties and 16% of the total U.S. population. Of course, many credit unions that are headquartered in urban areas have branches in rural areas. These institutions are not included in our analysis because financial results are not available at the branch level.

experience more personal financial difficulty; job losses mount; retirement funds dwindle; debt loads balloon; divorce rates rise. Small institutions come under tremendous pressure as they attempt to advise, consult with, and lend to these members.

Despite these substantial hurdles rural credit unions are posting comparatively strong results: their loan and savings growth rates are nearly identical to the national credit union norms. Their delinquency rates are nearly identical to the national average and their net chargeoff rates are about one-half the national credit union norm. They posted earnings declines, but also reflected stronger earnings results and report higher net worth ratios than the national credit union averages.

### **Rural Credit Unions Face Growing Concerns**

Although small, rural credit unions are relatively healthy and continue to play a vital role in the nation's economic recovery, that role is being threatened. There are several concerns raised by small credit unions – and rural credit unions in particular - that deserve mention.

#### *Regulatory Burden and Re-regulation.*

The credit union movement is losing small institutions at a furious pace – about one per day. Many of these are rural credit unions. The rate of decline does not seem to be slowing and most observers expect the pace to accelerate. The declines do NOT reflect failures but arise from voluntary mergers of small institutions into larger institutions. If you ask small institutions, they will tell you that one of the larger contributors to this consolidation is the smothering effect of the current regulatory environment.

Small credit union operators believe that the regulatory scrutiny they face is inconsistent with both their exemplary behavior in the marketplace and with the nearly imperceptible financial exposure they represent. A large community of small credit unions, free of unnecessary regulatory burden, benefits the credit union movement, the public at large and especially our rural communities. As the Subcommittee considers regulatory restructuring proposals, we strongly urge you to continue to keep these concerns in the forefront of your decision making. Moreover, we implore you to look for opportunities to provide exemptions from the most costly and time-consuming initiatives to cooperatives and other small institutions.

Both the volume of rules and regulations as well as the rate of change in those rules and regulations are overwhelming – especially so at small institutions with limited staff resources. Additionally, rural credit unions, like all credit unions, play “by the rules”. Yet, they correctly worry that they will be forced to pay for the sins of others and that they will be saddled with heavy additional burdens as efforts to re-regulate intensify.

Nevertheless, while others in the financial services community call for the Administration to back down on plans to create a separate Consumer Financial Protection Agency (CFPA), CUNA President and CEO Dan Mica met with Treasury Secretary Geithner last week to discuss the administration’s financial regulatory overhaul legislation. In that meeting, Mr. Mica signaled our willingness to work with the administration and Congress, to maintain a seat at the table and to continue the conversation to obtain workable solutions. Credit union member-ownership translates to a strong pro-consumer stance but that stance must be delicately balanced with the need keep our member-owned institutions an effective alternative in the marketplace.

Of course, any new legislation and regulation comes with possibility of unintended consequences, and credit unions are particularly sensitive to the unintended consequences of otherwise well intentioned legislation, especially given an issue that has arisen with respect to the Credit Card Accountability Responsibility and Disclosure Act (CARD Act).

#### *Credit Card Accountability, Responsibility and Disclosure Act*

CUNA supports the intent of the CARD Act to eliminate predatory credit card practices. Although it will require some adjustments in credit card programs in the next six weeks to provide a change-in-terms notice 45 days in advance and to require periodic statements to be mailed at least 21 days in advance before a late charge can be assessed, CUNA supports these provisions and credit unions are diligently working with their data processors to effectuate these changes by the August 20, 2009 effective date.

However, Section 106 of the CARD Act also requires, effective August 20, 2009, that the periodic statements for all open-end loans -- not just credit card accounts -- be provided at least 21 days before a late charge can be assessed. This means that a creditor must provide periodic

statements at least 21 days in advance of the payment due date in order to charge a late fee. Open-end loans include not only credit cards, but also lines of credit tied to share/checking accounts, signature loans, home equity lines of credit, and other types of loans where open-end disclosures are permitted under Regulation Z, the implementing regulations for the Truth in Lending Act. We believe extending the requirements of this provision beyond credit cards was unintended, and ask Congress to encourage the Federal Reserve Board to postpone the effective date of this provision.

If this provision is not postponed and considered further, the implementation of this provision will impose a tremendous hardship on credit unions. Simply put, we do not think credit unions can dismantle and restructure open-end lending programs they have used for decades in order to meet the August 20th deadline.

By way of background, this provision appeared for the first time in the Senate manager's amendment to H.R. 627. The House-passed bill only applied the 21-day requirement to credit cards and was to be effective in 2010. During the Senate's consideration of this issue, the 21-day requirement was described as applying only to credit cards.<sup>5</sup> In the weeks since enactment, many began to notice that the provision was not limited to credit card accounts and wondered if it was a drafting error. The confusion over this provision continues, as evidenced by the fact that as recently as June 25, the Office of Thrift Supervision released a summary of the CARD Act which states that the 21-day rule only applies to credit cards.<sup>6</sup>

There is a great deal of uncertainty about this particular provision, which makes it quite understandable that creditors may not even know about the ramifications of this new provision and the changes they need to have in place in six weeks.

This provision creates unique issues for credit unions because of their membership structure; as you know, credit unions serve people within their fields of membership who choose to become members. Because of this membership relationship, most credit unions provide monthly membership statements which combine information on a member's savings, checking and loan accounts other than for credit cards. For almost 40 years -- since the implementation of

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<sup>5</sup> Remarks of Senator Dodd during consideration of S. Amdt. 1058 to H.R. 627. *Congressional Record*, May 11, 2009, S5314

Regulation Z -- credit unions have been authorized to use multi-featured open-end lending programs that allow credit unions to combine an array of loan products and provide open-end disclosures for compliance purposes. Today, almost half of the nation's credit unions -- about 3,500 credit unions -- use these types of open-end programs, which can include as open-end lending products loans secured by automobiles, boats, etc.

CUNA is still trying to determine the full impact of the new law if credit unions will have to provide a 21-day period before the payment due date of all open-end loan products. Here are some preliminary compliance problems we have identified:

(1) Credit unions will need to consider discontinuing the use of consolidated statements, something they cannot possibly do in the next six weeks, because different loans on the statements often have different due dates.

(2) In order to comply with the 21-day mailing period, credit union members will no longer be able to select what day of the month they want designate as their due date for their automobile payments, a practice often allowed by credit unions, and no longer may be able to have biweekly payments to match repayments with biweekly pay checks, which helps members to budget.

(3) Credit unions may have to discontinue many existing automated payment plans that will fail to comply with the 21-day requirement and work with members to individually work out new plans in order to comply with the law.

(4) The 21-day requirement as it applies to home equity lines of credit (HELOCs) may raise contractual problems that cannot be easily resolved.

These complicated changes simply cannot be executed within the next six weeks, and CUNA requests that Congress urge Federal Reserve Board to limit the August 20 effective date to the two *credit card* provisions in Section 106, at least for credit unions.

*Credit Union Lending to Small Businesses*

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<sup>6</sup> <http://files.ots.gslsolutions.com/25308.pdf>

As noted above, credit unions have been able to “stay in the game” while other lenders have pulled back. The credit crisis that many small businesses face is exacerbated by the fact that credit unions are subject to a statutory cap on the amount of business lending they can do. This cap – which is effectively 12.25% of a credit union’s total assets – was imposed in 1998, after 90 years of credit unions offering these types of loans to their members with no significant safety and soundness issues. CUNA believes that the greater the number of available sources of credit to small business, the more likely a small business can secure funding and contribute to the nation’s economic livelihood.

Currently, 26% of all rural credit unions offer member business loans to their members. These loans represent over 9% of total loans in rural credit union portfolios. In contrast member business loans account for less than 6% of total loans in the movement as a whole. Total member business loans at rural credit unions grew by over 20% in the year ending March 2009, with agricultural MBLs increasing by over 12% and Non-Ag MBLs increasing 26% in the 12 month period. This is strong evidence that rural credit unions remain “in the game” during these trying times. But more could be done.

And more should be done. A chorus of small business owners complains that they can’t get access to credit. Federal Reserve surveys show that the nation’s large banks tightened underwriting standards for the better part of the past year. In 2005, an SBA research publication noted that large bank consolidation is making it more difficult for small businesses to obtain loans.<sup>7</sup> Given the fact that the average size of a credit union member business loan is approximately \$216,000 this is a market that credit unions are well suited to serve. And this is a market that credit unions are eager to serve.

Chairman Johnson, you undoubtedly hear a lot of rhetoric surrounding credit union member business lending. However, please allow me to paint a more complete picture of the member business loan (MBL) activity of credit unions.

Member business loans that credit unions provide their members are relatively small loans. Nationally, credit union business lending represents just over one percent (1.06%) of the

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<sup>7</sup> Small Business Administration. The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks. March 2005.

depository institution business lending market; credit unions have about \$33 billion in outstanding business loans, compared to \$3.1 trillion for banking institutions.<sup>8</sup> In general, credit unions are not financing skyscrapers or sports arenas; credit unions are making loans to credit union members who own and operate small businesses.

Despite the financial crisis, the chief obstacle for credit union business lending is not the availability of capital—credit unions are, in general, well capitalized. Rather, the chief obstacle for credit unions is the arbitrary statutory limits imposed by Congress in 1998. Under current law, credit unions are restricted from member business lending in excess of 12.25% of their total assets. This arbitrary cap has no basis in either actual credit union business lending or safety and soundness considerations. Indeed, a subsequent report by the U.S. Treasury Department found that business lending credit unions were more regulated than other financial institutions, and that delinquencies and charge-offs for credit union business loans were “much lower” than that for either banks or thrift institutions.<sup>9</sup>

The statutory cap on credit union member business lending restricts the ability of credit unions offering MBLs from helping their members even more, and discourages other credit unions from engaging in business lending. The cap is a real barrier to some credit unions establishing an MBL program at all because it is costly to create an MBL program and it is easy to reach the cap in fairly short order – this is especially true for small rural institutions. The cap effectively limits entry into the business lending arena on the part of small- and medium-sized 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. For example, the average rural credit union that does not now engage in business lending has \$17 million in average assets. At the institution level, that translates to roughly \$2 million in MBL authority which, in turn translates to an average of only nine loans.

The cap is overly restrictive and undermines public policy to support America’s small businesses. It severely restricts the ability of credit unions to provide loans to small businesses at a time when small businesses are finding it increasingly difficult to obtain credit from other types of financial institutions, especially larger banks.

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<sup>8</sup> All financial data is March 2009. Credit union data is from NCUA; Bank data is from FDIC.

<sup>9</sup> United States Department of Treasury, “Credit Union Member Business Lending.” January 2001.

Today, only one in four credit unions have MBL programs and aggregate credit union member business loans represent only a fraction of the commercial loan market. Eliminating or expanding the limit on credit union member business lending would allow more credit unions to generate the level of income needed to support compliance with NCUA's regulatory requirements and would expand business lending access to many credit union members, thus helping local communities and the economy.

While we support strong regulatory oversight of **how** credit unions make member business loans, there is no safety and soundness rationale for the current law which restricts **the amount** of credit union business lending. There is, however, a significant economic reason to permit credit unions to lend without statutory restriction, as they were able to do prior to 1998: America's small businesses need the access to credit. As the financial crisis has worsened, it has become more difficult for small businesses to get loans from banks, or maintain the lines of credit they have had with their bank for many years.

A growing list of small business and public policy groups agree that now is the time to eliminate the statutory credit union business lending cap, including the Americans for Tax Reform, the Competitive Enterprise Institute, the Ford Motor Minority Dealer Association, the League of United Latin American Citizens, the Manufactured Housing Institute, the National Association for the Self Employed, the National Association of Mortgage Brokers, the National Cooperative Business Association, the National Cooperative Grocers Association, the National Farmers Union, the National Small Business Association, the NCB Capital Impact, and the National Association of Professional Insurance Agents.

We hope that Congress will eliminate the statutory business lending cap entirely, and provide NCUA with authority to permit a CU to engage in business lending above 20% of assets if safety and soundness considerations are met. We estimate that if the cap on credit union business lending were removed, credit unions could—safely and soundly—provide as much as \$10 billion in new loans for small businesses within the first year. This is economic stimulus that would not cost the taxpayers a dime, and would not increase the size of government.

### **Conclusion**

In closing, Chairman Johnson, Ranking Member Crapo and all the members of this Subcommittee, we appreciate your review of these issues today. Every day, credit unions reinforce their commitment to workers, small business owners and a host of others in rural communities seeking to better their quality of life by providing loans on terms they can afford and savings rates that are favorable. We look forward to working with you to ensure the credit union system continues to be an important bulwark for the 92 million individuals and small businesses that look to their credit union for financial strength and support.