



Testimony of

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On behalf of

The National Association of Federal Credit Unions

“Credit Unions: Member Business Lending”

Before the

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Introduction

Good morning, Chairman Johnson, Ranking Member Shelby and Members of the Committee. My name is Mike Lussier and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU) where I currently serve as Chairman of the Board of Directors. I appreciate the opportunity to share my views with the committee on credit unions and member business lending. I have served as President/CEO of Webster First Federal Credit Union (Webster First), headquartered in Worcester, Massachusetts since 1990. I earned my Bachelor's of Business Administration, majoring in Accounting from Bentley College and my Master's of Finance from Nichols College.

Webster First is a community credit union with over 44,000 members and more than \$570 million in assets. Founded as a Polish-ethnic credit union in January of 1928, Webster First changed to a community credit union in 1956 and became federally chartered in 1995.

Throughout my career, I have been active in the credit union community. Prior to my chairmanship, I served on the Executive Committee of the NAFCU Board. Additionally, I have been a member of the Small Business Loan Review Board, was a Director for the Credit Union League of Massachusetts Insurance Agency, and served as Chairman of the Massachusetts Share Insurance Corporation Board.

As you may know, NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of nearly 800 member owned and operated federal credit unions. NAFCU member credit unions collectively

account for approximately 62 percent of the assets of federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding member business lending and allowing credit unions to further assist in the economic recovery.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for nearly 93 million Americans.

Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 USC 1752(1)). While more than 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost, personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks; they are better. The nation's approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members—while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting de-personalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost.

Although it is not the subject of this hearing today, I would be remiss if I did not personally thank Senators Tester and Corker, and those who supported their recent efforts to try to bring needed changes to the Durbin debit interchange price-control provision that was added to the Dodd-Frank Wall Street Reform and Consumer Protection Act. Like member business lending,

this issue is of great importance to credit unions and the consumers they serve, as it will have a direct impact on the ability of credit unions to meet the needs of their membership.

Background on Credit Union Member Business Lending and the Arbitrary Cap

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, they put in place restrictions on the ability of credit unions to offer member business loans. Congress codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets. Also, pursuant to section 203 of CUMAA, Congress mandated that the Treasury Department study the issue of credit unions and member business lending.

In January 2001, the Treasury Department released the study, "Credit Union Member Business Lending" and found the following:

"...credit union's business lending currently has no effect on the viability and profitability of other insured depository institutions." (p. 41). Additionally, when examining the issue of whether modifying the arbitrary cap would help increase loans to businesses, the study found that "...relaxation of membership restrictions in the Act should serve to further increase member business lending..." (p. 41).

CUMAA also established, by definition, that a business loan of \$50,000 and above is a member business loan that counts toward the cap. This number was not indexed and has not been adjusted for inflation in the nearly 13 years since enactment, eroding the *de minimis* level. Where many vehicle loans or small lines of credit may have been initially exempt from the cap

in 1998, many of those that meet the needs of small business today, are now included into the cap due to this erosion. To put this in perspective relative to inflation since 1998, what cost \$50,000 in 1998 costs \$69,000, using the May consumer price index data. That is a 38% rate of inflation change that is completely ignored by current law and which greatly hamstrings a credit union's ability to meet its members' needs.

Many in the banking community who oppose the aid to small business that changes to the cap would bring often try to cite safety and soundness issues with credit unions and business lending. Perhaps the better question would be whether a number of banks should be making commercial business loans. An examination of 1st quarter 2011 call report data shows that credit unions with MBL's have the same annualized net charge-off rate for business loans (1.12%) as commercial lending banks. Furthermore, they are actually better equipped for the charge-offs as they have a higher coverage of delinquent loans with their allowance account (101.72%) than those commercial lending banks (57.85%). NAFCU would welcome the opportunity to appear before the Committee on a hearing on this topic examining the banks.

The banking industry also argues that the credit union MBL cap should not be raised due to the credit union federal tax exemption. What the banking industry conveniently forgets to mention is that a large number of banks do not pay corporate federal income tax because of their Subchapter S status. There are approximately 2,377 Subchapter S banks that avoid federal income taxes today. What the banking trades don't want you to know, is that one estimated

value of the Subchapter S federal tax break for banks is \$2.05 billion for 2010, *which is actually greater* than the estimated value of the entire credit union tax expenditure (\$1.27 billion) for FY2010 as included in the President's FY2012 budget message. Perhaps the issue the Committee should be holding hearings on is the unfair advantage banks have over credit unions due to their Subchapter S federal tax break.

The Arbitrary Cap Today

Credit unions have been critical in helping our country recover from the financial crisis, and members of Congress on both sides of aisle recognize that they were not the cause of it. Many credit unions have capital to lend small businesses across the country and are in a position to further assist in recovery efforts. However, due to the outdated and arbitrary member business lending cap, their ability to help stimulate the economy by providing credit to small businesses is hampered. Removing or modifying the outdated and arbitrary credit union member business lending cap would help provide needed economic stimulus.

Some short-sighted critics claim that only a limited percentage of credit unions are actually at the arbitrary member business lending cap and therefore nothing needs to be done. This view fails to see the big picture of how the arbitrary cap acts as a deterrent for efforts to increase business lending and create American jobs. Successful business lending programs like ours at Webster First often require investment in human and other resources by the institution. Those credit unions that have some member business lending but are not near the cap, have an artificial disincentive in the arbitrary cap, because, if they are successful in growing and expanding their

business lending program, they will ultimately reach this arbitrary barrier forcing them to scale down what they invested in to build up.

Member Business Lending at Webster First FCU

Webster First has been at the outdated and arbitrary credit union member business lending cap for almost a year now. On the business lending side, we offer numerous products including real estate loans, lines of credit, small business equipment loans, auto and truck loans, and a few small stores that do floor plans. We have a well diversified portfolio with minimal delinquencies. Our commercial losses have also been minimal as we have a sincere and devoted membership.

At Webster First, we understand that member business lending is not about credit unions, but about helping small businesses and the jobs they create. It is unfortunate that we cannot handle all the requests we receive due to the outdated and arbitrary member business lending cap. It is with our liquidity, strong surplus, and experienced staff, that Webster First could continue to help the small businesses in our community, many of which feel threatened and treated unfairly by other institutions.

Webster First has made some great in-roads into business lending and has assisted multiple families and businesses in becoming quite successful. For example, we helped an individual

purchase an older gas service station from his parents. He was able to upgrade all his pumps, computer services and revamp his store. It now includes a coffee shop, package store, and a 10 pump service station. His success allowed him to then upgrade the unused property behind the station for storage rental units which quickly became 90% utilized. He recently sold the property for a substantial profit and has now acquired other properties to expand his business. As the Committee knows, business expansion means job creation.

We have assisted many real estate owners who own multi-family units in refinancing their existing mortgages from other institutions. These institutions refuse to allow them to rewrite due to the fear that real estate values have not hit bottom. Many of these property owners have plenty of cash, net worth and positive cash flow, but the banks they approached for financing declined the entrepreneurs' requests and would not work with them. We put them through an intensive analysis, document their credit and payment history, and have been able to revive the possibility of continued ownership via lesser rates, smaller payments, and continued positive cash flow.

Recently, a Latino radio station owner wanted to expand his radio station ownership to acquire some local radio stations in order to better accommodate the Latino market in Worcester. Because of the risk associated with radio stations, many banks would not consider his request. We reviewed the contracts, cash flows, equity position and collateral, and were able to finance his dream. He is now the largest Latino radio station owner in all of Massachusetts. We have not only assisted this individual, but in working with him, we were also able to increase our

marketing and business opportunities within the under-banked community. We have since put a credit union branch in this underserved area.

One of the newest areas we have been able to enter is small-town downtown rehabilitation. We recently hired an individual who is well versed in SBA lending. He is attempting to assist those within our community who may be better served by using our products along with SBA products. As the Committee is aware, guaranteed portions of SBA loans do not count toward the outdated and arbitrary credit union member business lending cap. As the arbitrary cap has hamstrung our efforts to meet the member business lending needs of our membership, SBA loans have at least offered some alternative until the outdated and arbitrary restrictions can be changed.

Credit Union Member Business Lending Legislation in the 112th Congress

In March 2011, Senator Mark Udall of Colorado introduced bipartisan legislation, the *Small Business Lending Enhancement Act* (S.509), which would raise the arbitrary credit union member business lending cap to 27.5 % of total assets, up from 12.25%, and help stimulate the nation's struggling economy by increasing access to credit for small business owners. This important legislation has 19 Senate co-sponsors, including Majority Leader Reid. Identical legislation (H.R. 1418) has been introduced in the House by Representative Ed Royce of California.

The *Small Business Lending Enhancement Act* is a well thought out solution that includes important provisions to ensure that safety and soundness concerns are addressed. This bill is not about helping credit unions, it is about helping small businesses.

In order to see its cap increased, a credit union would need to meet strict eligibility requirements to gradually increase its member business lending portfolio, including: being well capitalized [currently at least a 7% net worth ratio]; having at least 5 years of member business lending experience; must be at or above 80% of the current 12.25% cap for at least 1 year before applying; and, must be able to demonstrate sound underwriting and servicing based on historical performance and strong management. The requirements in this legislation mirror those sought by Senator Mark Udall last year, when his efforts were endorsed by Treasury Secretary Timothy Geithner and NCUA Chairman Debbie Matz.

As evidenced by the strict eligibility requirements outlined above, the *Small Business Lending Enhancement Act* was specifically tailored to address concerns that raising the current cap could somehow create safety and soundness issues.

Unlike efforts enacted by Congress to provide \$30 billion to promote business lending at community banks, it is worth noting that raising the arbitrary and outdated member business lending cap for credit unions only scores at a cost of \$77 million over 5 years according to a 2010 CBO estimate. Furthermore, this cost does not take into account added tax revenue that would be gained from the jobs created by enacting this legislation. This pales in comparison to the price tag for what Congress did for the community banks in the last Congress when the *Small*

Business Jobs Act created a \$30 billion “Small Business Lending Fund” (SBLF) with the intention of encouraging community banks to lend to small businesses. To date the program has created very few if any jobs, and has done little to spur economic growth for its \$30 billion price tag. Furthermore, it has been reported that only about 30% of eligible banks have expressed interest in participating. During recent hearings in the Senate Small Business Committee, it came to light that a large number of the banks that have applied for the program also received taxpayer funds from the Troubled Assets Relief Program (TARP). Clearly this effort to promote business lending at community banks has had a lack of success.

Credit unions stand ready to do their part in continuing to assist America’s small businesses. Failing to consider legislation to raise the arbitrary member business lending cap last Congress was a missed opportunity to further assist small business and help move the economy in a positive direction. NAFCU and its member credit unions ask that the *Small Business Lending Enhancement Act* be considered by the Banking Committee and on the Senate floor as soon as possible.

Conclusion

The artificial credit union member business lending cap established in 1998 is arbitrary and outdated. The need for such a cap was questioned by the Treasury Department as far back as 2001. While NAFCU believes that no statutory cap should be in place, a number of credit unions like mine, and the millions of members we serve, would benefit from the enactment of the *Small Business Lending Enhancement Act*. This legislation would provide a practical and well-thought out approach to raising the arbitrary threshold, while addressing concerns about rapid

growth and safety and soundness. NAFCU would also support raising the *de minimis* \$50,000 definition of a member business loan as it has eroded upon enactment last century.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's economy. I would welcome any questions that you may have.