Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

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Hearing on

"Credit Unions: Member Business Lending"

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Opening

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I am Noah Wilcox, fourth generation President and CEO of Grand Rapids State Bank and a member of the Executive Committee of the Independent Community Bankers of America. Grand Rapids State Bank is a state chartered community bank with $236 million in assets located in Grand Rapids, Minnesota. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on credit union member business lending.

ICBA appreciates this opportunity to testify on legislation (S. 509) that would expand credit union powers by raising the cap on member business loans as a percentage of assets. We strongly oppose the Small Business Lending Enhancement Act. Congress should not expand credit union business lending powers unless it is also prepared to tax credit unions and require them to comply with the Community Reinvestment Act. The credit union tax exemption is directly linked to and can only be justified by their original mission of serving individuals of modest means. Any expansion of their powers beyond the original mission should result in the loss of their tax exemption.

I want to make clear that community bankers strongly support locally-based non-profit organizations. I have served on a number of non-profit boards, including the Grand Rapids Area Community Foundation and the Itasca County Family YMCA. Many of my community bank colleagues perform similar service. These non-profits justify their tax exemption by serving a public mission. Our concern is that credit unions, having strayed far from their statutory mission, are abusing their tax exempt status and are seeking to go even farther.

This topic is not in the least abstract for me. For my bank, credit union business lending represents an immediate threat. I'm happy to compete with other tax-paying lenders, even large banks, but the credit union tax exemption creates an unfair advantage and distorts the market. I have very aggressive credit unions in my market. On countless occasions, I've lost business lending opportunities with established customers to credit unions who underpriced my competitive rates. Just last Friday, as I was preparing for this hearing, a longtime customer, with both personal and commercial lending relationships, told me they were taking three loans to two different credit unions. One of the loans was a loan on real estate for development that the credit union priced about 400 basis points less than our rate, which is competitive. This rate is even lower than can be accounted for by the tax advantage, suggesting that the credit union, inexperienced in business lending, did not appropriately price the risk. The second loan is a small commercial loan. And the third loan is a mortgage on the borrower's residence, on which, though it does not qualify for the secondary market, the credit union, has offered a rate in the mid-3 percent range.

S. 509 would allow the NCUA to approve member business loans that raise a credit union's total amount of outstanding loans to 27.5 percent of assets – more than double the current cap of

12.25 percent. The current cap was established in 1998 as part of the Credit Union Membership Access Act, which completely undermined the original "common bond" requirement for credit union customers. The 1998 law reversed a recent Supreme Court decision and allowed credit unions to serve a customer base with multiple common bonds. Because the law made the common bond requirement nearly meaningless, the member business lending cap was deemed especially important to maintain a distinction between credit unions and banks. The 12.25 percent cap was not chosen arbitrarily but was intended to ensure that commercial lending would comprise no more than a marginal part of a credit union's lending.

The credit unions have portrayed S. 509 as an effort to make more credit available for small businesses. The truth is that only a small number of credit unions are at or near the current member business lending cap – we estimate this number to be about 0.5 percent of the approximately 7,400 credit unions. Over 70 percent of credit unions report no member business loans at all. Those credit unions that are at or near the cap are the largest and most complex credit unions, and the business loans they make are often multi-million dollar, speculative, commercial loans – not small business loans. There is ample capacity for the remaining 99.5 percent of credit unions to expand their member business lending. The fact that only 4.5 percent of credit union assets are invested in commercial loans – a figure cited by advocates of S. 509 – does not suggest that the current cap of 12.25 percent is too low. What's more, there are numerous exceptions to the member business lending cap, including:

- Any loan of less than $50,000;
- Small Business Administration loans, including 7(a) and 504 SBA loans of up to $5 million;
- Non-member loans and loan participations purchased from other credit unions;
- Loans made by any credit union grandfathered by the 1998 law because they had a history of making business loans or were chartered for the purpose of making business loans;
- Loans made by low income or community development financial institutions; and
- Loans secured by the borrower's primary residence.

With regard to this last exception, I note that some of the examples of supposed commercial credit union loans cited by advocates of S. 509 are actually loans secured by the borrower's residential mortgage, which are not subject to the cap. These loans are not small business loans based on the lender's understanding of the business's cash flow, debt coverage, and other factors that go into commercial credit underwriting. Rather, they are second mortgages based on the home's value as collateral should the business fail -- a type of lending that is irresponsible at best.

S. 509 is not driven by the need to bring credit to small businesses. It is driven by a small number of credit unions who want to increase their assets and their revenues while still enjoying their tax-exempt status.

Credit Unions Lack Expertise in Commercial Lending

What's more, commercial lending is not for novices. It takes many years of experience and a firm grasp of the commercial environment to properly evaluate a business loan application, to value the collateral, and to understand the risk and price accordingly. Credit unions lack the experience and the expertise to safely conduct commercial lending, and their regulator, the NCUA, lacks experience in supervising commercial lending. I recognize that S. 509 includes provisions that are intended to ensure that credit unions have a track record – however limited – in commercial lending. These provisions are inadequate and leave too much discretion to the NCUA. As we emerge from the financial crisis and economic recession, this is the wrong time to jeopardize the safety and soundness of our financial system.

Credit Unions Not Fulfilling Their Tax-Exempt Mission

The purpose of the cap on member business loans established by the 1998 law was to ensure credit unions would focus on serving members of modest means, not commercial lending. Numerous independent studies have concluded that credit unions are not fulfilling their core mission.

A 2005 study by the National Community Reinvestment Coalition determined that banks do a better job of fulfilling the credit unions' mission than the credit unions. The study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities." A 2003 Government Accountability Office study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks."

Another study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle and upper-income customers than lower-income households. Similarly, a study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base.

The recent push by many credit unions into payday lending makes a travesty of their original tax-exempt mission. A recent investigation conducted by *The Washington Post* documents credit union payday lending abuses. While many credit unions offer short term, small dollar loans under reasonable terms, some credit union products are nearly as predatory as those offered by a store front check casher. The *Post* identified at least 15 credit unions that offer high cost loans closely resembling payday loans. In particular, some credit unions earn commissions by acting as fronts for third party lenders with names such as "QuickCash" and "CU on Payday."

Credit unions' involvement in a Florida real estate investment scheme, dubbed "Millionaire University," illustrates just how far credit unions have strayed from their original tax-exempt mandate to serve low and moderate income families and into risky business loans. In this scheme a number of credit unions granted speculative out-of-market land development loans to residents from far away states. Borrowers became credit union 'members" by paying a $5 dollar membership fee. Three of those credit unions failed. What original members were served in their home states of Colorado and Michigan when these credit unions made risky loans on Florida real estate? Congress cannot allow tax-exempt credit unions so stray even further into such risky business lending endeavors by increasing the business lending cap while remaining subsidized by taxpayers.

Congress explicitly placed limits on the types of lending tax-exempt credit unions can do for a good reason – so credit unions can focus their efforts on serving people of modest means that share a common bond. This is not only better for local communities; it is also a much safer form of lending.

Credit Union Lending Comes at a Significant Cost to Taxpayers

The neglect of credit unions' original mission is unfair to the people credit unions were intended to serve; it's unfair to taxpaying community banks, but it's also unfair to all taxpayers. Some advocates of S. 509 claim that expanded credit union commercial lending would come at "no cost to taxpayers." This is patently false. Lending by tax-exempt credit unions displaces lending by taxpaying banks, and thereby reduces tax revenue to the government. In light of the urgent need to reduce the federal budget deficit, we must consider the cost-benefit analysis of the credit union tax exemption.

The most comprehensive analysis of the credit union's federal tax exemption was undertaken by the non-partisan Tax Foundation in 2005. This analysis considered not only the cost of the tax subsidy, but what happens to the tax subsidy – i.e., whether and to what extent it is passed on to customers – and the effect of the subsidy on the marketplace for financial services. The Tax Foundation found that:

- The value of the tax subsidy was $2 billion in 2003 – and growing to over $3 billion annually today. This included not only the direct tax expenditure that resulted from not taxing the net revenue of credit unions, but the indirect effect on tax revenues of a less competitive marketplace for financial services. This is a more comprehensive analysis of the tax subsidy than is provided by the Joint Committee on Taxation and the Office of Management and Budget, which consider only the static tax expenditure and exclude behavioral changes in the marketplace. Still, JCT and OMB also confirm the dramatic growth of the tax expenditure in recent years.
- The subsidy would cost the taxpayer over $32 billion over a ten-year budget window.
- The subsidy boosted the return on assets, for the average credit union, by 50 basis points.

- Of those 50 basis points, only a meager 6 basis points are passed onto customers in the form of lower interest rates on loans. There is little to no effect on deposit rates. 11 basis points are absorbed by higher labor costs at a credit union than at a comparable bank (due to inefficiencies).
- The remaining 33 to 44 basis points of subsidy accrue to the credit union owners in the form of higher equity and larger assets they use to expand rapidly.

In summary, the Tax Foundation study shows that credit unions generally do not pass on their subsidy to customers. However, the competitive threat to community banks comes from the fact that credit unions have the *option* to use the subsidy to secure business they want. This is what I see repeatedly in my business. The credit union loan that I mentioned earlier, that was underpriced by 400 basis points, was surely made possible by the tax subsidy, and perhaps a failure to adequately evaluate the risk. Given the projected growth in the federal budget deficit in the coming years and the threat it poses to our national prosperity, we can no longer afford a tax subsidy divorced from its original purpose that generates no public benefit and poses a threat to tax-paying community banks. This view is also shared by the Debt Reduction Task Force of the Bipartisan Policy Center, Chaired by former Senator Pete Domenici and former OMB Director Alice Rivlin, whose recent report recommends eliminating the tax exemption for credit unions. In addition, the Congressional Budget Office, in its annual "Budget Options" report, noted the option of taxing large credit unions. Any serious effort to reduce the deficit must consider the merits of repealing the credit union tax exemption. While I have focused my comments on the federal budget, the credit union tax exemption also deprives state and local governments, many of which are facing cuts to essential public services to remain solvent, of desperately needed revenue.

The recent bailout of corporate credit unions further demonstrates the fundamental unfairness of the tax exemption. On September 24, 2010 three corporate credit unions were taken into conservatorship by the NCUA, bringing the total to five over a period of 18 months. Seventy percent of corporate credit unions assets were held under conservatorship. The corporate credit unions had invested in $50 billion of subprime, private label, mortgage-backed securities, a failure of prudent lending illustrating that their judgment seems to have been no better than that of the Wall Street banks that also had to be bailed out. Had NCUA not intervened with the provision of a taxpayer-funded backstop, consumer credit unions would have suffered system-wide losses of an estimated $40 billion and as many as 30 percent of federal credit unions would have failed, according to NCUA estimates. Credit unions benefit from taxpayer resources when times are rough, but they do not contribute when they are profitable. This is an affront to taxpayers and to the community banks that sustain their communities and the nation with hard-earned tax dollars. Community banks pay their fair share; credit unions should be held to the same standard.

The case for repealing the exemption stands on its own merits as a deficit reduction measure. When considered in the context of the current effort by credit unions to expand their business lending powers and become the equivalent of banks, linking expanded lending powers to repeal of the tax exemption is a matter of fairness and free market principle. If credit unions seek to have no distinct business model verses commercial banks than Congress must tax them under any equitable tax system.

Credit Unions Could Convert to Mutual Thrifts

The implicit reason for expansion of member business lending proposed in S. 509 appears to be that the current credit union charter is inadequate for the needs of some credit unions and their customers. However, ICBA believes that there is a far more appropriate alternative for them. If they need bank powers to better serve their customers, they should be encouraged to convert to a Federal savings association charter. Over 30 credit unions have taken advantage of this option, despite the substantial roadblocks that the National Credit Union Administration has put in the way of credit union-to-thrift conversions.

Conclusion

Thank you again for convening this important hearing. As a community banker, I feel the direct impact of credit union commercial lending, so I'm grateful for the opportunity to provide my perspective.

ICBA strongly urges this committee to reject calls for new powers for the tax-subsidized credit union industry that will not, despite assertions to the contrary, expand small business credit or create jobs. ICBA adamantly opposes S. 509 as an unjustified and unfair credit union power-grab at the expense of taxpaying community banks and individuals. Credit unions should be granted no new powers as long as they remain tax exempt and are not even meeting their statutory mission to serve individuals of modest means.

Thank you for this opportunity to testify and express the views of the community banking sector.