



Testimony of

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On behalf of

The National Association of Federal Credit Unions

**“Small Business Lending: Perspectives from the Private Sector”**

Before the

House Small Business Committee Subcommittee on

Investigations, Oversight and Regulations

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## **Introduction**

Good morning, Chairman Coffman, Ranking Member Schrader and Members of the Subcommittee. My name is Bob Marquette, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). Thank you for holding this important hearing today. I appreciate the opportunity to share our views on small business lending from a lender's perspective.

Currently, I serve as the President and CEO of Members 1<sup>st</sup> Federal Credit Union headquartered in Mechanicsburg, Pennsylvania, a position I have held for 14 years. Established in 1950, Members 1<sup>st</sup> FCU has approximately 213,000 members, over 700 employees and more than \$2 billion in assets. We now provide a full range of financial services through our 51 branches throughout south central Pennsylvania. I have been involved with credit unions for 39 years, including regulatory experience with the National Credit Union Administration (NCUA) and my current role on the Board of Directors of NAFCU.

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 over 800 member-owned and operated federal credit unions. NAFCU member credit unions collectively account for approximately 66 percent of the assets of federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this important and timely discussion.

## Background on Credit Unions

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 meet a precise public need—a niche credit unions fill today for nearly 94 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 over 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 financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation’s approximately 7,000 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 depersonalization in the delivery of financial services by banks, the emphasis in consumers’ minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

### **Artificial Member Business Lending Cap at Credit Unions Hurts Small Business**

When Congress passed the *Credit Union Membership Access Act* (CUMAA) (P.L.105-219) in 1998, it put in place restrictions on the ability of credit unions to offer member business loans. Credit unions had existed for nearly 90 years without these restrictions. 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.

CUMAA also established, by definition, that business loans above \$50,000 count toward the cap. This number was not indexed and has not been adjusted for inflation in the nearly 14 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 these types of loans that meet the needs of small business today are now impacted by the cap due to this erosion. To put this in perspective relative to inflation, what cost \$50,000 in 1998 costs \$70,500 today, using the May consumer price index data. That is a 41% rate of inflation change that is completely ignored by current law and greatly hamstrings a credit union's ability to meet its members' needs.

It should be noted that the government guaranteed portions of SBA loans do not count toward the member business lending cap, but the non-guaranteed portions do. This could ultimately lead to a situation where a credit union may be an excellent, or even preferred, SBA lender and ultimately have to scale back participation in SBA programs as they approach the arbitrary cap. This would likely hit SBA Express or Patriot Express loans first, as those have lower guarantees and thus may have a bigger impact on money available below the cap. As you know, Patriot Express loans help give our nation's veterans more opportunities after they return from serving our country. The member business lending cap can deter the availability of those opportunities.

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).

The 2001 Treasury study found that credit unions do not pose a threat to the viability and profitability of banks, but that in certain cases, they could be an important source of competition for banks. It is important to note that credit unions have a nominal market share of the total commercial lending universe (approximately 6% of all small business loans from insured depository institutions), and are not a threat to banks (who control nearly 94% of all small business loans from insured depository institutions) in this environment.

A 2011 study commissioned by the SBA's Office of Advocacy affirms these findings. (James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Small Business Research Summary, SBA Office of Advocacy, No. 387 (Sept. 2011)). The SBA study also indicates, importantly, that credit union business lending has increased in terms of the percentage of their assets both before and during the 2007-2010 financial crisis while banks' has decreased. This demonstrates not only the need for lifting the MBL cap in order to meet credit union members' demand, but also that credit unions continue to meet the capital needs of their business members even during the most difficult of times. One of the findings of the study was that bank business lending was largely unaffected by changes in credit unions' business lending. Additional analysis in the study also found that credit unions' business lending can actually help offset declines in bank business lending during a recession.

Bipartisan legislation to address this issue, in the form of H.R. 1418, the *Small Business Lending Enhancement Act*, is pending before the Financial Services Committee. We would urge Committee members to support this important bill.

Even our nation's main street businesses have recognized that the artificial cap hurts job creation and access to capital for small business, and have supported H.R. 4293, the Restore Main Street's Credit Act of 2012, introduced by Subcommittee Ranking Member Kurt Schrader. This legislation would help exempt loans made to Main Street Businesses from the artificial cap. We thank him for his leadership on this important bill.

#### **Member Business Lending at Members 1<sup>st</sup> Federal Credit Union**

Members 1<sup>st</sup> launched our member business lending (MBL) program in January 2003. We are pleased that Members 1<sup>st</sup> has continually met our local communities lending needs since that time and has not decelerated our lending pace. However, that streak is in doubt as we are quickly approaching the artificial cap for our credit union.

Recently, a number of major financial institutions financing new car floor plan inventory at dealerships decided to exit our market. When we looked at stepping in to replace their financing, we realized that we could not do so as we were approaching the arbitrary cap.

The average loan size for our MBL loans is \$185,000, and the majority of them are for owner-occupied small businesses. Since the end of 2007, our business loan applications have grown from \$87 million to \$259 million in 2011. While some lenders have entered and exited the

business lending marketplace in this time, we have strived to be a consistent source of credit for our small business members.

We estimate that Members 1<sup>st</sup> funded business loans in 2011 created 52 new jobs in our area and helped save 269 more. Currently, we have 3 business loan officers but we have not increased that number since 2005 due to the artificial cap. Raising the artificial cap would allow us to hire more employees, better meet the loan demand and be even more competitive with our loan rates.

### **SBA Lending at Members 1<sup>st</sup> Federal Credit Union**

At Members 1<sup>st</sup> Federal Credit Union we have originated two loans in the SBA 7(a) program and three loans in the SBA 504 program. In both cases of our 7(a) loans, the businesses were existing businesses that were expanding. The 7(a) loans helped the businesses obtain additional capital, as SBA guidelines allow for a wider use of funds (such as franchise and professional fees and working capital) than the National Credit Union Administration (NCUA) regulations.

However, both 7(a) loans took nearly a year to fund. We partnered with a local Community Development Corporation to help guide us through the SBA 7(a) process and train our staff. We found the process quite time consuming and burdensome for our credit union. It left us with the impression that an established business lender (such as Members 1<sup>st</sup>) seeking to enter into the SBA marketplace seems to be on the bottom rung of the SBA priority list. The multiple tiers within the SBA 7(a) program give larger lenders a competitive advantage in speed over

community banks and credit unions. The difference in processing time between a Preferred Lending Program (PLP) lender and a non-PLP lender has grown to months, and effectively acts as a barrier to a new lender entering the SBA marketplace.

I would note that Members 1<sup>st</sup> has had success using the SBA 504 loan program since our launch into business lending. That program and the USDA Business & Industry loan program has been well-received by our members. Both of these programs treat all incoming applications equally regardless of the financial institution's history with the SBA. Members 1<sup>st</sup> has paused actively marketing our SBA 7(a) loans until we find a solution that can more efficiently meet our members' needs.

### **SBA and Access to Capital for Credit Union Members**

Small businesses are the backbone of our economy and an important source of jobs for Americans. The Small Business Administration's loan programs serve as an important resource that helps credit unions provide small businesses with the vital capital necessary for growth and job creation. However, utilizing any SBA loan guaranty program requires meeting stringent government regulations.

Determining overall applicant eligibility to participate in an SBA program is nearly as important as determining the applicant's creditworthiness. Failing to meet certain eligibility criteria may

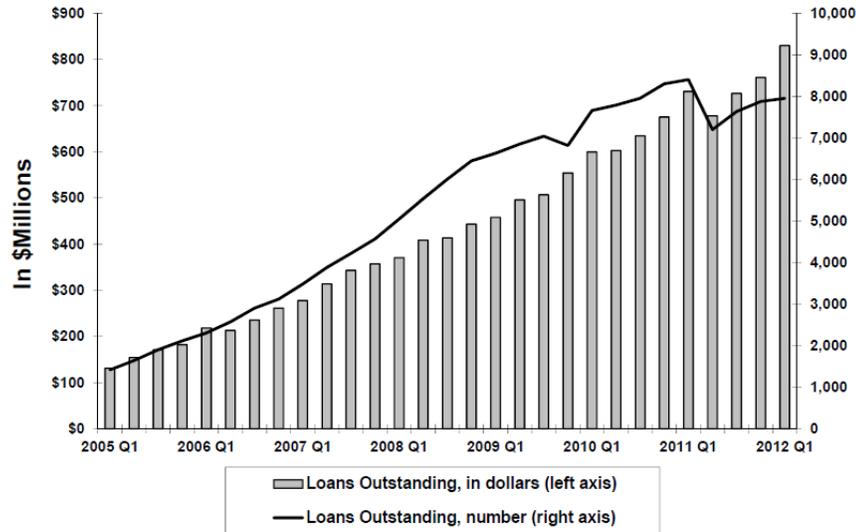
preclude the applicant from participating in an SBA guaranteed loan program. Eligibility criteria includes among other things: size restrictions, type of business, use of proceeds, credit standards, and meeting a 'credit-elsewhere' test.

NAFCU is pleased that SBA Administrator Karen Mills has been open to meeting with, and hearing the concerns of, credit unions about SBA programs. We hope that this dialogue can continue and be productive.

While credit union SBA loans have generally increased in both total number and dollars, the growth rate of credit union SBA lending has fallen during the recession (see charts below).



# FICU SBA Loans



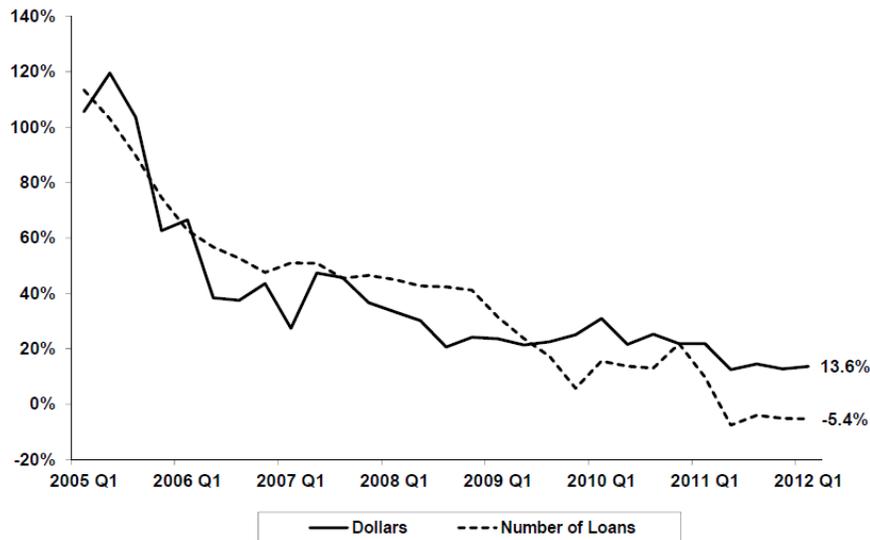
Source: NCUA

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# FICU SBA Loans

## Year-Over-Year Growth



Source: NCUA

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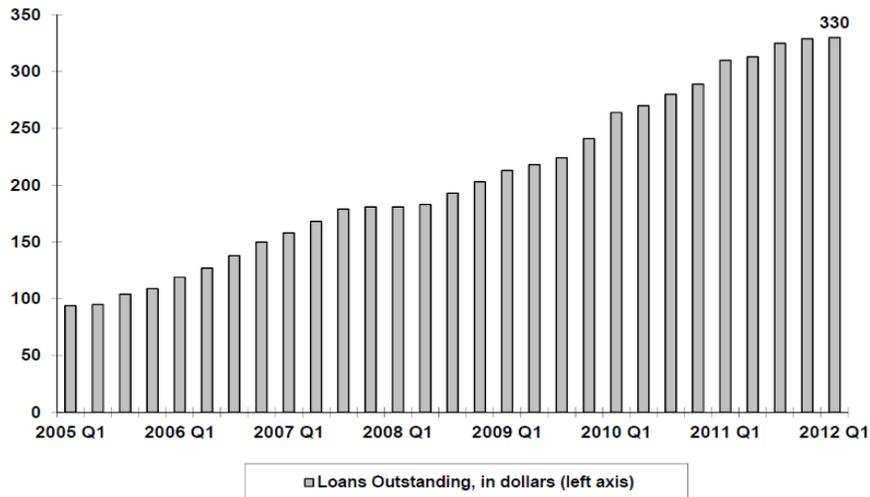
There is a way that these concerns outlined in my testimony can be addressed. NAFCU supports H.R. 4191, the *Credit Union Small Business Lending Act*, introduced by Subcommittee Ranking Member Kurt Schrader and full committee member Representative Steve Chabot. This bipartisan bill would amend the Small Business Act to: (1) direct the SBA Administrator to implement a program to provide outreach and assistance to credit unions to increase their participation in the SBA small business loan program; (2) simplify the application process for such participation; (3) provide a guarantee of up to 85% for loans made by credit unions to their members in underserved areas; and, (4) clarify the participation of credit unions in the SBA's 504 loan program. These steps would make the process easier for credit unions to become more involved in SBA lending and open the door to more access to credit for those small businesses and communities served by credit unions.

As you can see from the chart below, the number of federally-insured credit unions participating in SBA programs has been steadily increasing since the SBA opened up its programs to more credit unions in 2003. Enacting legislation such as the *Credit Union Small Business Lending Act* will help this trend continue, and also increase the number of SBA loans these credit unions extend to their small business members.



# FICU SBA Loans

Number of FICUs with Outstanding SBA Loans



Source: NCUA

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If Congress and the SBA were to make it easier for credit unions to participate in these programs, small businesses throughout the nation will have greater access to capital at a time when it is needed most. While we support SBA loans being permanently exempted from counting against a credit union's MBL cap in full, we also would support efforts to temporarily increase the guarantee on SBA loans. Our experience indicates that the recent SBA fee reductions and temporary guarantee increase helped the small businesses in our market.

These suggested changes, which allow credit unions to do more to help our nation's small businesses, are an important step to help our nation recover from the current economic downturn.

## **Conclusion**

Small businesses are the driving force of our economy and the key to its success. The ability for them to borrow and have improved access to capital is vital for the job creation that will lift our nation out of the economic malaise in which we find ourselves today. And while the Small Business Administration's financial programs are providing much needed opportunities to established and fledgling businesses, there are still obstacles withholding the programs from their full potential. We are confident this subcommittee will do what is necessary to ensure that these programs are successful, while ensuring eligibility requirements and other qualifying criteria aren't overly burdensome on the financial institutions that participate in them.

That is why we, on behalf of our nation's credit unions, their 94 million members and our nation's small businesses urge the Committee to support legislation, such as H.R. 1418 and H.R. 4191, to make it easier for credit unions to aid our nation's small businesses and create jobs.

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.