CUNA
Credit Union National Association

Jim Nussle
President & CEO

601 Pennsylvania Ave., NW
South Building, Suite 600
Washington D.C 20004-2601

Phone: 202-508-6745
Fax: 202-638-7734
jnussle@cuna.coop

April 15, 2015

The Honorable John Thune
Chairman
Business Income Tax Working Group
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Benjamin Cardin
Co-Chairman
Business Income Tax Working Group
Committee on Finance
United States Senate
Washington, DC 20510

Dear Senator Thune and Senator Cardin:

On behalf of the Credit Union National Association (CUNA), I am writing in strong support of the preservation of the credit union tax status. CUNA represents nearly 90 percent of America's 6,300 state and federally chartered credit unions and their 102 million members. Credit unions are Americans' best option for financial services and the credit union tax status represents one of the best investments that the government makes in its citizens. We urge Congress to retain and reaffirm the credit union tax status.

The importance of having not-for-profit credit unions as vibrant and viable alternatives in the financial services marketplace is as significant today as it has ever been. Credit unions provide accessible and affordable basic financial services to people of all means and encourage the equitable distribution of capital across all individuals, families, communities, and small businesses. Credit unions infuse financial market competition with multiple and differentiated competitive business models. They help keep financial services accessible – and affordable – for all consumers, whether they are members of a credit union or not.

In the aftermath of the financial crisis, more Americans are choosing credit unions as their best financial partner. In fact, more than 12 million Americans have joined credit unions since 2008. Some may have joined because their bank failed, moved or was acquired by another institution; and others may have joined because they grew frustrated with the policies and fees of the for-profit sector. What's important is that when they needed an alternative, a healthy credit union system with the capacity to grow was ready to serve them, and as credit union members, they benefit from conducting their financial services with an institution that they own. The credit union tax status is crucial to encourage and support the continued existence of this alternative, cooperative component of the financial system.

This letter provides a brief background on credit unions and their tax treatment as well as an overview of the reasons that Congress should retain the tax status. We are willing to discuss these matters further with the Working Group.

Congress should preserve the credit union tax status because:

- the tax treatment of credit unions continues to serve the purpose for which it was conveyed;
- the tax status represents good public policy because it causes the creation of substantial benefits to the public, far in excess of its cost; and,
- taxing credit unions would represent a tax increase on 102 million Americans—taxpayers who paid a total of $1.2 trillion in taxes in 2014—and would likely lead to the elimination of many, if not most, credit unions.

Background on Credit Unions and the Credit Union Tax Status

Credit unions are member-owned, democratically governed, not-for-profit cooperative financial institutions generally managed by volunteer boards of directors, with a specified mission of promoting thrift and providing access to credit for provident purposes to their members, especially those of modest means.[1] Membership in an individual is restricted to its field of membership, a concept that was originally used as a creditworthiness tool. Today, credit union fields of membership can include geographical areas in additional to employee, church or organizational fields. An individual is not eligible to join any credit union, but we believe there is at least one credit union that every American is eligible to join. Some of the earliest credit unions were formed to provide small business credit to members to fund entrepreneurial endeavors; over the years, credit unions have adapted to meet the credit needs of their members, whether it is short term, small dollar personal loans, mortgage loans, car loans, or small business loans.

Credit unions were established at the Federal level during the Great Depression, but existed in many states as far back as 1908; their inception was driven by a demand for access to basic financial services – loans and savings. Through the enactment of the Federal Credit Union Act and the credit union tax status, as well as enabling legislation in all 50 states, Congress and the states have sanctioned and encouraged the development of a dual-charter credit union system that is an alternative to the for-profit banking sector, comprised of financial institutions controlled by members and accessible to all.

The tax code from its earliest days has properly recognized the unique status and structure of Credit unions. From the beginning, credit unions' tax treatment has been based on their structure

[1] 14 USC 12 § 1751.

and the mission.[2] This basis has been reaffirmed several times since 1917, including in 1937 when Congress made clear in statute the tax status of Credit Unions; and in 1998, when Congress enacted the Credit Union Membership Access Act. Today, federally chartered credit unions' tax status is made clear by Section 501(c)(1) of the Internal Revenue Code; state chartered credit unions tax status is made clear by Section 501(c)(14) of the Internal Revenue Code. These tax policies were reaffirmed by the Internal Revenue Act of 1986. This is an important distinction as other tax policies were not specifically affirmed by the Act.

The Tax Treatment of Credit Unions Continues to Serve the Purpose for which it was Conveyed

Credit unions' federal income tax treatment has been conveyed in order to support and sustain a system of cooperative financial services in the United States. The existence of this thriving set of alternative consumer-owned financial institutions benefits not only the members of credit unions, but also customers of for-profit banks and other institutions. A safe, sound and growing credit union system is a clear indication that the tax treatment of credit unions continues to serve the purpose for which it was conveyed.

As the years have passed, the financial services sector has developed, and the entities providing financial services—including credit unions—have evolved. Some have suggested that with the evolution of expanded services offered by credit unions, they have become simply untaxed banks. That position ignores the very real differences that distinguish investor-owned and cooperative firms. The fact of the matter is that even though credit union services have evolved, their structure and mission have remained the same. Precisely because of their cooperative structure, credit unions behave differently from investor-owned financial institutions, and that difference in behavior produces substantial benefits both to the nation's 102 million credit union members, and also to non-members and the economy as a whole.

[2] Credit unions were first made tax exempt in 1917 through a ruling by the United States Attorney General. The ruling noted that, "On examination of the purpose and object of such association, it appears that they are substantively identical with domestic building and loan associations or cooperative banks 'organized and operated for mutual purpose and without profit' [quoting from the 1916 statute]. It is to be presumed that the Congress intended that the general terms used in Section 11 should be construed as not to lead to injustice, oppression, or an absurd consequence." This served as the basis for the exemption of state chartered credit unions from federal income tax until 1951, when mutual savings banks lost their tax exemption because they were deemed to have lost their mutuality but credit unions retained their tax exemption because, as is the case today, they hold firm to their mutuality and cooperative principles. Federally chartered credit unions were made exempt from federal income tax in 1937.

Two features of the cooperative structure are crucial in generating substantial benefits to society: their total focus on member value and service, and their tendency to risk aversion. Because of credit unions' strong member focus, driven by their democratic governance structure, credit unions have every incentive to not only "pass on" but also to leverage the benefits of their tax status rather than diverting it in some form of expense preference.[3] The cooperative structure also discourages excessive risk taking by credit unions. Because they take on less risk, they tend to be less affected by the business cycle, and therefore can serve as an important counter cyclical economic force in local markets, softening the blow of economic downturns in local economics. In addition, credit unions' member focus and the absence of a strong profit motive allow them to offer significant advantages to their members of modest means.

The Credit Union Tax Status Is Good Public Policy and the Benefits Resulting From the Status Vastly Outweigh the Costs

As a consequence of their member-focused, cooperative structure, credit unions confer on their members and the rest of society reaps benefits that far exceed the amount of revenue the Treasury would ever gain by imposing a new tax on credit unions. The benefits that credit unions provide to both members and others amount to an estimated $10 billion in just 2014. Their tax status is leveraged because credit unions do not pay dividends to stockholders, generally do not compensate their directors, and do not compensate senior executives as highly as banks do when stock options and grants are taken into consideration.

Credit unions provide benefits directly to their members in the form of lower fees, lower rates on loans, and higher yields on deposits than those available at other financial institutions. Applying rate differentials from a third party source (Informa Research Services) to the volumes of various loan and deposit accounts at credit unions, and applying fee differentials to credit union non-interest income, allow us to calculate the total amount that members benefit from using credit unions. In 2014, we calculate the total of member benefits to have been almost $8 billion. In

[3] *Expense preference* refers to managerial behavior that places the preferences of managers (inflated salaries and benefits, perquisites, lavish offices, etc.) ahead of the otherwise recognized goals of the firm. In an investor owned firm, expense preference behavior would result in sacrificing profit (investor value) for managerial preferences. For tax-exempt credit unions, expense preference behavior would imply providing excessive managerial emoluments rather than using or leveraging the tax exemption for the benefit of members. There is NO evidence of expense preference resulting from the tax exemption: Comparing similarly sized banks and credit unions, both have expense-to-asset ratios in the range of 3 to 3.5%; the aggregate 11.0% credit union capital ratio is four percentage points higher than the level regulators consider to be "adequate" but is no higher than the aggregate bank equity capital ratio; also, as noted elsewhere in this letter, compensation comparisons between banks and credit unions show lower compensation for credit union senior executives at similar sized institutions – and substantially lower compensation when data on bank stock options, grants and similar non-cash compensation is considered.

addition, several independent researchers have found that credit unions have a moderating influence on bank pricing: raising bank deposit interest rates and lowering bank loan rates.[4] Based on this research, we estimate that bank customers saved about $2 billion in 2014 from more favorable pricing due to the presence of credit unions in their local markets.

Compared to historical measures of these consumer benefits, the total of $10 billion in 2014 was relatively subdued because of the unusually low level of most interest rates during the year. When all interest rates are compressed near zero, there is less room for typical differences between credit union and other rates. Prior to the financial crisis, the combined member and non-member benefits totaled more than $12 billion annually, and these levels are likely to be achieved again in the future once interest rates rise.

In addition to these quantifiable benefits, credit unions also provide consumers of financial services significant intangible benefits. As member-owned and governed institutions, credit unions focus on providing exceptional member (customer) service. This too places competitive pressure on banks to follow suit. In the 21 years from 1985 to 2005, the *American Banker* newspaper published an annual survey of consumers of financial services, and each year credit unions scored much higher than banks in customer service. We are aware of sessions at bank conferences with titles such as "Emulating the Customer Service of Credit Unions." This is just another way that the existence of a cooperative alternative to investor-owned banks has value not only to credit union members but also to bank customers.

The incentives faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) induce management to eschew higher-risk, higher-return strategies.[5] As a result, credit union operations are less risky, and subject to less volatility over

---

[4] Robert J Tokle, *The Influence of Credit Unions on Bank CD Rate Payments in the US*, New York Economic Review, Fall 2005. Timothy H. Hannan, *The Influence of Credit Unions on the Rates Offered for Retail Deposits by Banks and Thrift Institutions,* Federal Reserve Board of Governors, September 2002. Robert M. Feinberg, *The Competitive Role of Credit Unions in Small Local Financial Services Markets,* Review of Economics and Statistics, August 2001. Robert M. Feinberg, *The Effects of Credit Unions on Bank Rates in Local Consumer Lending Markets,* Filene Research Institute, 2001.

[5] Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, Journal of Banking and Finance, 20 (September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.

the business cycle. For example, from 1992 to 2014, the average annual net charge-off rate on credit union loans was 0.61%, with a standard deviation of 0.22%. In contrast, the similarly computed average at banks over the same period was 0.89%, with a much greater standard deviation of 0.60%.

Because of this lower-risk profile, credit unions were able to continue lending during the recent financial crisis while other financial institutions failed or had to curtail operations due to damaged balance sheets caused by riskier practices leading up to the crisis.

Homeowners benefited from having credit unions in the market during the financial crisis. As the secondary market for residential mortgages collapsed in 2007, the amount of first mortgages originated by credit unions actually rose by 11% in 2007 and 18% in 2008.

Likewise, credit unions were an oasis for small business owners when banks withdrew their offerings and exited the market. From June 2007, the onset of the financial crisis, to December 2014, small business loans outstanding at credit unions grew by 90.8% while such loans at banks actually declined by 12.0%. A Small Business Administration study found, "that credit unions are increasingly important sources of small business loans as a longer-run development and in response to fluctuations in small business loans at banks."[6]

The tax status, by fostering the continued existence of credit unions as a cooperative alternative in the market, supports this countercyclical lending role for credit unions.

Credit unions offer full and fair service to all of their members, and credit union membership tends to be concentrated in the working class of Americans. Over half of credit union members who rely primarily on their credit union for financial services have incomes between $25,000 and $75,000. Credit unions also do not shy away from serving their members where they are most needed. Nationwide, 49% of credit union branches are located in CDFI investment areas, compared to only 42% of bank branches in such areas.

Compared to other providers, credit unions offer services to lower-income members at prices that are very attractive, and with less of a price differential to services offered to higher income members. In fact, credit unions sometimes charge their lower-income members less for a service than banks charge even their higher-income customers. For example, a recent study found that

[6] James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending,* Office of Advocacy, Small Business Administration, September 2011. p v.

the fees banks collect on an annual basis on low balance checking accounts ($218) are two and a half times what they collect on their high-balance accounts ($90).[7] In contrast, fees credit unions collect on low-balance accounts ($80) are less than a third of those collected by banks on low-balance accounts, are even less than what banks collect on high-balance accounts, and are less than twice what they collect on their own high-balance accounts ($42). In other words, consumers generally get better deals from credit unions than from banks, and this is particularly true for lower income members.

In addition to providing access to financial services, credit unions also endeavor to provide financial literacy education to their members, and to encourage individual and family level thrift and saving. Sixty nine percent of credit union members belong to a credit union that offers some form of financial education. Fifty seven percent of credit unions members belong to a credit union that offers financial literacy workshops. Twenty percent of credit union members belong to a credit union that operates one or more in-school branches. Credit unions engage in this activity not just through altruism, but also because it is in the best interest of the credit union to have members who are educated on how to best use the cooperative.

Through these and other activities, credit unions employ the tax status to fulfill the purpose for which it was created. As a result, the credit union tax status has proved not only to be good public policy but also to represent an incredible return on the investment that the government has made.

Taxing Credit Unions Would Increase Taxes on 102 million Americans and Likely Lead to the Elimination of Many—if not most—Credit Unions

Some in the for-profit financial services sector would like to see Congress repeal the credit union tax status. Doing so, however, would undoubtedly result in negative consequences for savers and borrowers, the most severe of which would be the erosion of a credit union option for millions of Americans. If taxed, a very significant number of larger credit unions are expected to covert to banks to take advantage of the much greater flexibility of a bank charter, and an equally significant number of smaller credit unions would simply liquidate. The remaining credit unions would have to pass the burden of taxation through to their members because they are wholly owned cooperatives, increasing the cost of accessing mainstream financial services.

---

[7] Victor Stango and Jonathan Zinman, *What People Pay: Deposit Account Fees at Banks and Credit Unions,* Filene Research Institute, November 2009. The authors, from the University of California, Davis and Dartmouth College analyzed the results of actual account usage at banks and credit unions. The annual fee totals are the result of the volume of various types of transactions, and the pricing of those transactions.

The Honorable John Thune
The Honorable Benjamin Cardin
April 15, 2015
Page Eight

One of the motivations behind comprehensive tax reform is to reduce distortions of resource allocation caused by preferences and exemptions, thereby allowing a reduction in corporate tax rates by expanding the tax base. There would be little to be gained by imposing a new tax on credit unions. For the past two decades credit unions have accounted for only 6% to 7% of the assets in US depository institutions. Nevertheless, as I described above, more than 102 million working-class Americans—taxpayers who in 2014 paid $1.2 trillion in taxes—benefit in an amount much greater than any possible amount the Treasury could collect from a misguided new tax imposed on credit unions. If credit unions were taxed in 2014, the receipts would have accounted for only 0.05% of 2014 federal government spending – an amount that would have funded U.S. government operations for five hours. It makes absolutely no sense to wipe out the substantial benefit Americans receive from having a credit union option for five hours of government operation. We encourage Congress to retain and reaffirm the credit union tax status.

On behalf of America's credit unions and their 102 million members, thank you very much for your consideration of our views.

Sincerely,

Jim Nussle
President & CEO