THE "NEW BREED" OF CREDIT UNIONS IN OKLAHOMA

I. EXECUTIVE SUMMARY

This white paper examines the reality of today's competitive marketplace in which commercial banks and thrifts face increasing competition from a "new breed" of credit unions – entities offering a full range of financial products and services that have expanded far beyond their original scope and purpose.

These entities continue to have their growth subsidized by the American taxpayer. As they have evolved over the last thirty years, this "new breed" of credit union bears little resemblance to traditional credit unions for which the original exemption from various taxes was established in 1937.

In Oklahoma, each of the twelve largest credit unions:

(1) has total assets in excess of $100 Million – (combined they have assets of $4.4 Billion or 77 percent of total credit union assets in Oklahoma);
(2) offers an array of products and services that is indistinguishable from those offered by tax-paying banks and thrifts; and
(3) welcomes virtually anyone who applies for "membership."

Last year these twelve "new breed" credit unions collectively earned a total of $57.2 Million in profits, representing approximately 88 percent of the total Oklahoma credit union industry's earnings.

By continuing to abuse their tax-exempt status in order to facilitate growth, these twelve "new breed" credit unions caused the United States to forfeit approximately $14.3 Million in federal income taxes in 2002. Five of the twelve are federally-chartered credit unions and, as such, they are exempt from all taxes except real and personal property taxes. The State of Oklahoma forfeited another $1.79 Million in state *in lieu of* taxes, and another $664,749 in state and local sales taxes from these five federal credit unions in 2002.

This money was forfeited at the expense of the Oklahoma and American taxpayer, but the abuse goes deeper than that. By hiding behind the "credit union" label, these "new breed" credit unions got away ***without contributing anything*** to pay for Homeland Security and our national defense, or for our local teachers, police, firefighters, and highways.

And this was just in calendar year 2002. Left unchecked, this "new breed" of credit union presents a systemic risk to our nation's fully regulated and tax-paying financial services system. Over time they will continue to facilitate the movement of business from the tax-paying, well-regulated financial services sector (commercial banks and thrifts) to a casually-regulated and tax-free industry (credit unions). That's bad public policy at every level.

If there is no discernable difference between the products provided or the customers served, what justification can remain for preferential tax treatment?

Ultimately, public policy makers must evaluate whether this "new breed" of credit union has "graduated" and evolved into an institution that is indistinguishable from tax-paying financial services providers. With rising federal deficits and increased costs for the war on terror, American and Oklahoma taxpayers deserve nothing less from their elected officials.[1]

II. BACKGROUND

A. CREDIT UNIONS HAVE GROWN DRAMATICALLY

The Federal Credit Union Act was passed on June 26, 1934, and defines a "federal credit union" *as "a cooperative association organized . . . for the purpose of promoting thrift among its members and creating a source of credit for provident and productive purposes*".[2] These entities were primarily authorized to deal with problems of scarce credit in a Depression era environment. Their primary customers were people of modest means who would not otherwise qualify for credit from traditional, tax-paying lenders.

Historically, "membership" in these not-for-profit financial cooperatives was limited to a common bond of some sort, usually a place of employment, where people of limited means borrowed from and saved with one another. Borrowers and savers worked together, knew each other, and supported the concept of "character" loans. It was this commonality of interest among the members that made credit unions unique.

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[1] It is with deep appreciation that the Task Force acknowledges the numerous resources provided by the American Bankers Association and, specifically, the assistance and counsel provided to the Task Force by Dr. Keith Leggett, Ph D., Senior Economist, Economic Policy and Research, Office of the Chief Economist, American Bankers Association, Washington, D. C.

[2] 12 U.S.C. § 1752 (1).

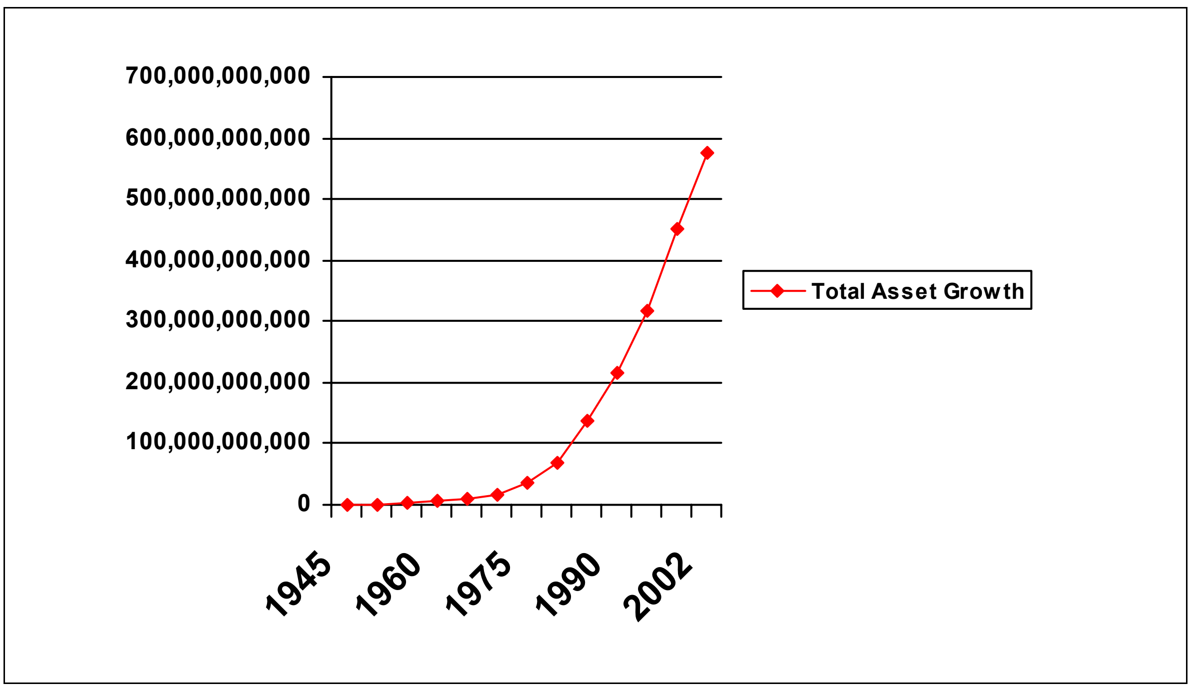
In 1940, there were 9,224 credit unions nationwide, serving 2,693,863 "members" and holding assets of $248,958,325. As is evident from these numbers, the early credit union industry was made up of small institutions, offering a limited number of services to their customers, and focusing on service to people of limited means.

The growth of credit unions nationwide has been rather dramatic as shown by the accompanying chart. By 1960, the number of credit unions had more than doubled – to a total of 20,094 institutions serving more than 12 Million "members" – and their assets had increased 20-fold, to $5.66 Billion.

By 1980, the number of institutions increased only slightly – to 21,465 – but the number of "members" served increased 3½ times, to 43.9 Million. Total assets increased by more than $60 Billion, to $68.9 Billion.

Twenty-two years later, at the end of 2002, the real trend became evident. The total number of credit unions nation-wide dropped to 10,041, while the number of "members" grew to include about 29 percent of the total U.S. population. And **total assets grew by half a Trillion dollars** from 1980 to 2002, from $68.9 Billion to $574.7 Billion![3]

Credit Union Asset Growth – 1945 – 2002



[3] As of mid-2003, the total asset size of the credit union industry was $610 Billion.

B. IN OKLAHOMA, FEDERAL CREDIT UNIONS AVOID MORE TAXES THAN DO STATE- CHARTERED CREDIT UNIONS.

Federal credit unions make up about sixty percent of the industry across the nation. In Oklahoma, that percentage is slightly higher, with 65 of the state's 93 credit unions operating under federal charters. The state's 93 credit unions serve 952,082 "members" and held $5,743,301,071 in total assets as of December 31, 2002.

Federal credit unions are exempt from federal and state income taxes as a matter of federal law. The tax exemption was created in 1937, when Congress amended the Federal Credit Union Act to prevent the federal government and the states and local authorities from imposing any taxes (except real and personal property taxes) on federal credit unions.[4]

State-chartered credit unions, on the other hand are also exempt from federal income taxes, but derive that exemption from Section 501 (c) (14) of the Internal Revenue Code. In Oklahoma, state-chartered credit unions are subject to the corporate *in lieu of* tax and are also subject to state and local sales taxes.

III. KEY LEGISLATIVE AND REGULATORY CHANGES LEADING TO THE EMERGENCE OF A NEW BREED OF CREDIT UNIONS

A. ADDITIONAL PRODUCTS AND SHARE INSURANCE

The early credit unions were unique and served a different population than the one served by traditional tax-paying commercial banks and thrifts.[5] However, product offerings and membership requirements have changed, resulting in a bifurcation of the industry itself. Here's how it has evolved.

In 1968, federal credit unions were first authorized to issue secured loans with maturities of up to ten years. That same year the unsecured loan limit for federal credit unions was increased to $2,500.

In 1970, the National Credit Union Administration (NCUA) was established to regulate federal credit unions, and federal deposit insurance was extended to credit unions through the National Credit Union Share Insurance

[4] 12 U.S.C. § 1768
[5] U.S. General Accounting Office, Letter to the Honorable Paul S. Sarbanes, October 27, 2003.

Fund. With the addition of deposit insurance coverage came the beginning of a dynamic shift in the credit union industry. Since that change, the credit union industry has experienced substantial growth, and its activities and offerings have greatly expanded.

The tax exemptions granted by statute and by the Internal Revenue Code historically were intended to provide credit union customers (low- to moderate-income Americans) with better rates on both loans and savings instruments, rates that tax-paying entities could not match without jeopardizing their own safety and soundness. When share insurance for credit union customers was authorized, however, one of the major impediments to credit union expansion was removed, making them much more attractive to potential depositors.

Other changes were made in the authority of credit unions to offer different kinds of products and services. In 1977, amendments to the Federal Credit Union Act expanded savings, lending and investment powers,[6] and in 1980, credit unions were given permanent authority to issue checking accounts.

B. EXPANSION OF THE COMMON BOND – A REAL GROWTH SPURT

In 1982, the NCUA adopted new rules that changed the "common bond" requirement. The new rules – abolishing the prior understanding that federal credit union membership was limited to a single common bond in each instance – allowed the addition of multiple employer groups to a credit union's membership base, as long as each such group had its own "common bond." Coupled with share insurance, this rule change fueled the dramatic expansion and growth of large credit unions for the next 20 years.[7]

It was this rule change that was challenged by the American Bankers Association in 1990,[8] and that challenge resulted in the enactment of the Credit Union Membership Access Act (CUMAA) in 1998.[9] CUMAA has accelerated the development and evolution of the new breed of credit unions that exists

[6] 12 U.S.C. § 1757 (5).
[7] As noted above, credit union assets grew by more than $500 Billion between 1980 and 2002.
[8] The ABA was ultimately successful in its challenge in the U.S. Supreme Court. See National Credit Union Administration v. First National Bank & Trust, 118 S. Ct. 927 (1998).
[9] Pub. L. 105-219, August 7, 1998.

today, a broadly based financial services provider whose membership is open to virtually anyone. [10]

These institutions are virtually unrestricted in terms of customers they may serve and products they may offer.[11] They continue to leverage their tax advantage to grow and expand with their tax-free profits, at a cost of billions to the U.S. taxpayer. [12]

IV. THE COST TO OKLAHOMA TAXPAYERS

A. OKLAHOMA'S TOP TWELVE – A "NEW BREED" CREDIT UNIONS

While a large percentage of the total number of Oklahoma credit unions remain focused on their original, traditional purpose, a relatively small number have become large, sophisticated financial service institutions.

Twelve Oklahoma credit unions have more than $100 Million in total assets. Membership in each of them is open to virtually anyone who applies. These twelve credit unions control about 77 percent of total credit union assets in Oklahoma, and they have nearly 592,000 "members" – about 17 percent of the state's total population.

The following table lists these twelve "new breed" credit unions and their total assets as of December 31, 2002:

Name	City	Total Assets
Tinker FCU	Oklahoma City	$1,255,666,000
Tulsa Teachers FCU	Tulsa	627,166,000
Weokie CU	Oklahoma City	372,669,000
Communications FCU	Oklahoma City	367,697,000
Tulsa Fed. Employees FCU	Tulsa	361,636,000
66 FCU	Bartlesville	355,719,000
FAA Employees CU	Oklahoma City	249,222,000
Oklahoma Central CU	Tulsa	205,189,000
Oklahoma Employees CU	Oklahoma City	172,799,000
Fort Sill FCU	Lawton	143,996,000
Allegiance CU	Oklahaoma City	135,443,000
Energy One FCU	Tulsa	133,201,000

[10] As a p 80,
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[11] Although no attempt is made to draw a particular line as to where this "new breed" begins and ends, there are currently 83 credit unions in the United States with total assets of more than $1 Billion. 43 percent of the credit union industry's assets are held by credit unions with more than $500 million in total assets.

[12] Report of the General Accounting Office, October, 2003, GAO-04-92-Changes in Credit Union Industry, page 13.

BBy contrast, there are 272 commercial banks in Oklahoma, 210 of which are less than $100 Million in total assets. These smaller community banks are at even greater competitive risk from the activities of this new breed of credit unions.[13]

Using conservative estimates[14] the following table shows the income earned by these twelve entities (five of which are federally chartered credit unions which pay only real and personal property taxes) and the amount of federal and state taxes that were forfeited in 2002:

Name	Total Assets	ROA	Income	Federal Tax Forfeited	*In Lieu* Tax Forfeited	Sales Tax Forfeited
Tinker FCU	$1,255,666,000	1.54	$19,337,256	$4,834,314	$1,160,235	$446,053
Tulsa Teachers CU	627,166,000	1.68	10,536,389	2,634,097		
Weokie CU	372,669,000	1.23	4,583,829	1,145,957		
Communications FCU	367,697,000	1.20	4,412,364	1,103,091	264,742	70,402
Tulsa Fed. Emp. CU	361,636,000	1.03	3,724,851	931,213		
66 FCU	355,719,000	1.26	4,482,059	1,120,515	268,924	116,381
FAA Employees CU	249,222,000	0.68	1,695,710	423,677		
Oklahoma Central CU	205,189,000	1.89	3,878,072	969,518		
Oklahoma Emp. CU	172,799,000	1.17	2,021,748	505,437		
Fort Sill FCU	143,996,000	0.65	935,974	233,994	56,158	60,914
Allegiance CU	135,443,000	0.64	866,835	216,709		
Energy One FCU	133,201,000	0.56	745,926	186,481	44,756	41,488
Totals	**$4,380,403,000**		**$57,220,013**	**$14,305,003**	**$1,794,815**	**$654,749**

B. MEMBERSHIP "REQUIREMENTS" ARE VIRTUALLY MEANINGLESS

[13] See generally, J. Gunther and R. Moore, *"Small Banks' Competitors Loom Large,"* Southwest Economy, Issue 1, January/February 2004, Federal Reserve Bank of Dallas - http://www.dallasfed.org/research/swe/2004/swe0401b.html.

[14] The federal income tax rate assumed was 25 percent based on income calculated using ROA numbers associated with each institution. The state *in lieu of* tax is set at 6 percent. Sales taxes were estimated based on an assumption that 25 percent of operating expense constituted purchases that would have been subject to state and local sales tax rates, and were calculated based on the location of the main credit union office.

Membership in the twelve largest Oklahoma credit unions is virtually unrestricted. Here are just a few examples:

► You're ***eligible to join Tinker Federal Credit Union's more than 160,000 "Members" if you are:***

- Military or civilian personnel of the US Government assigned to or work at Tinker AFB (Midwest City) or Vance AFB (Enid), or an Army National Guard facility listed in the credit union's select employee group (SEG) listing, or one of the Armed Forces Reserve Centers in Oklahoma;
- A contractor or a contractor's employee who regularly works at any of those installations listed above;
- A member of the US Armed Forces, whether on active duty or retired, or a dependent, or a survivor of a dependent eligible to receive benefits from one of these installations;
- A member of a veteran's organization in Oklahoma;
- An elected official or employee of the cities of Ada, Del City, Edmond, Enid, Moore, Norman, Nash, Yukon, or Garfield County or Cleveland County;
- Related to anyone who is either a member of TFCU or qualifies to be a member of TFCU;

You're also eligible for membership in Tinker FCU if:

- You worship, live, work or attend school in Payne, Pontotoc or Seminole County;
- You work for or belong to any one of an alphabetical listing of employers or organizations including:

Academy Sports & Outdoors	**Big Red Sports & Imports**	**City Rescue Mission**
Cox Communications	**Delta Dental**	**Express Personnel**
First Baptist Church – MWC	**General Motors**	**Harold's Stores**
Journal Record Publishing	**Junior Achievement**	**Kerr McGee Corporation**
Kickapoo Tribe of Oklahoma	**McAlester Reg. Med. Cen.**	**Norman Regional Hospital**
Oklahoma Bar Assoc.	**Oklahoma Nurses Assoc.**	**Oklahoma City Univ. (F&S)**
OK Christian Univ. (F&S)	**Pre-Paid Legal Services**	**Rose State College F&S)**
Shawnee Chamber of Comm.	**Soil Conservation Svc. –Hugo**	**Teamsters Local Union # 886**
Univ. of Central OK. (F&S)	**Westin of Oklahoma City**	

or any one of ***an additional 350-plus*** individual businesses and organizations.

Just in case you're interested in having your business establish a relationship with Tinker FCU, it has ***"business development representatives"*** who, among other things, call on businesses and encourage them to enroll the business as a SEG. From their website:

> **"TFCU offers great features for your business such as direct deposit and payroll deduction. Take advantage of curbside service to your business with our Mobile Service Center, a TFCU branch delivered right to your door."**
>
> **"Gain a competitive edge in attracting and retaining qualified employees. Offering Tinker Federal Credit Union membership is a perfect choice to enhance your benefits package without increasing your costs. Your employees will have access to comprehensive financial services that will save them money in lower fees and low loan rates."**

► ***You're eligible to join Tulsa Teachers Credit Union's 70,000-plus "Membership" – one that proudly notes its reality as "a full-service financial institution" – if you are:***

- An immediate family member *(spouse, child, mother, father, brother, sister, aunt, uncle, grandparent, grandchild, stepparents, stepchildren and adoptive children)* of, or living in a household with, ***anyone who is eligible*** for membership (*even though he or she is not a member).*
- An employee of nearly ***300 SEG's*** located in a 14-county area.
- In a recent television commercial in Tulsa, TTCU proudly proclaims that ***one need not be a teacher to be a member; rather, eligibility for membership comes with residence in a one-million population geographic area***, and "typical" members were shown, including a physician, an airline pilot and a white-collar business professional.

► You're ***eligible to join Weokie Credit Union and become one of its 50,000 members if you:***

- Live, work, worship or attend school in Oklahoma, Canadian, Cleveland, Logan, McClain or Pottawatomie counties, a geographic area that includes more than 1.2 million people.

- Work for or are related to someone who works for any one of ***550 SEG's, including:***

Albertson's Stores	**Bass Pro Shops**	**The Chickasaw Nation**	
Oak Tree Country Club	**Oak Tree Golf Club**	**YMCA**	**YWCA**

And employees of a long list of cities, including:

Beaver	**Buffalo**	**Chickasha**	**Chouteau**	**Coalgate**
Comanche	**Fairfax**	**Fairview**	**Frederick**	**Guymon**
Heavener	**Idabel**	**Jones**	**Miami**	**Pawhuska**
Ponca City	**Pond Creek**	**Waurika**	**Waynoka**	**Weatherford**

► For ***a $5 deposit, you can become one of nearly 38,000 members of Communications Federal Credit Union in Oklahoma City and:***

- Either you or a relative is employed by or a member of one of more than ***400 SEG's*** including:

Oklahoma City Golf & Country Club	**Goodyear Tire & Rubber**
IBEW Local 226, 304, 584, 1002	**Mid-Continent Energy**
Kerr McGee Corp.	**OG&E**
ONEOK and subsidiaries	**Quail Creek Golf & CC**
Southern Hills Country Club (Tulsa)	**Twin Hills Golf & CC**

► For ***an initial $5 deposit, you can become one of more than 50,000 members of Tulsa Federal Employees Credit Union if you:***

Live, work, worship or attend school in Tulsa, Rogers, Wagoner, Creek or Osage Counties *(you don't have to be a federal employee – just live, work, worship or attend school in one of those counties).*

► ***You can become one of Federal Aviation Administration Employee's 33,000-plus members simply if you*** live, work, worship or attend school in Oklahoma, Canadian, Cleveland, Logan, McClain or Pottawatomie counties, an area that includes more than 1.2 million people.

► ***The same is generally true for Oklahoma Employees Credit Union and its 34,000-plus members*** – all you have to do is live, work, worship or attend school in Oklahoma, Canadian, Cleveland, Logan, McClain or Pottawatomie Counties – a geographic area that includes more than 1.2 million Oklahomans – or work for any one of:

- A large number of state agencies that don't have their own credit union, such as the Governor's Office, the Lieutenant Governor's Office, the Office of the Attorney General and the State Banking Department. – you or a family member who works in one of these agencies is eligible for membership.
- A number of Oklahoma counties, from Beckham (on the Texas border) to LeFlore (on the Arkansas border) and many in between.
- Several medical facilities ranging from the Broadway Clinic and Dean McGee Eye Institute. to the Presbyterian Hospital and OU Medical Center.

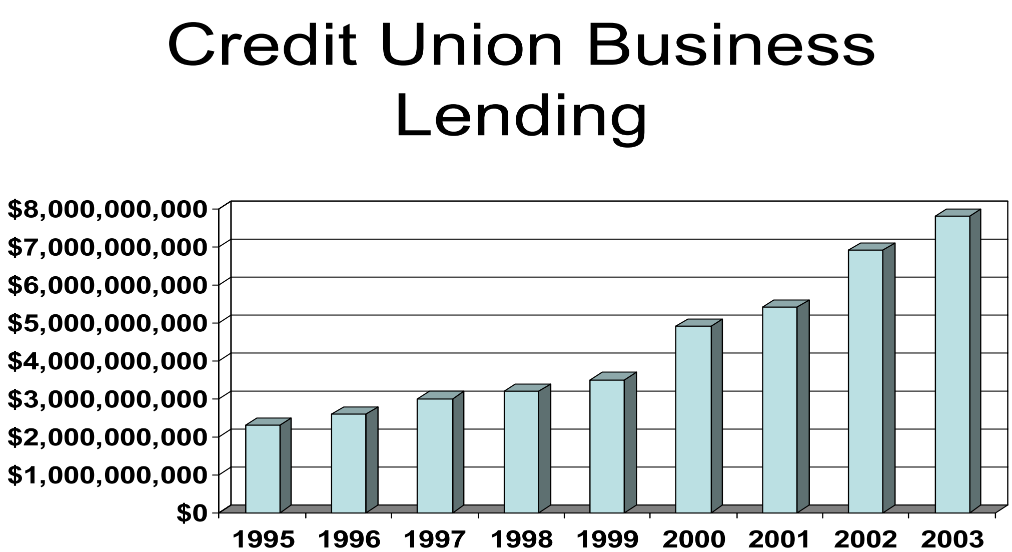
 66 FCU is available for employees of Conoco/Phillips and more than 80 other SEG's in the Bartlesville area. In addition, if you do not qualify because you're employed by (or a family member of someone who is employed by) one of those SEG's, 66 FCU will qualify a potential "customer" if that person is either qualified for or is actually a "member" of the Community Source Credit Union.

- To be eligible for membership in Community Source Credit Union one must live, work or worship in Washington, Osage or Nowata county, which is 66FCU's primary trade area.
- Who is Community Source? It's a small credit union affiliated with 66 FCU that they are helping to get established. All services, rates and fees are the same as, and served through, 66 FCU.
- Because of their relationship with Community Source, 66 FCU's potential "membership" base is dramatically larger than simply being an employee of one of the 80+ SEG's.

These are just some of the ways that Oklahomans can join these "new breed" credit unions. All of these entities are full-service financial institutions, offering checking and savings accounts, certificates of deposit, safe deposit boxes, Internet banking and bill paying on line, credit and debit cards, home loans, home equity loans, vehicle loans, small business lending and other consumer loans of all types – just like tax-paying banks and thrifts.

Weokie Credit Union is one of Oklahoma's leading SBA lenders. Their website has a separate page dedicated to ***"Weokie Member Business Loans: Financing Commercial Success."*** With a click of the mouse, Weokie will help prospective small business borrowers build a business plan and walk them through the process, whether it's an SBA-guaranteed loan, or a loan for a business start-up, a purchase or even a refinance loan.[15]

And Weokie is not alone. Recent statistics show that an increasing number of credit unions are extending their tax-subsidized services to small businesses and other commercial customers. Not only do more than 2,500 credit unions offer business checking accounts nationwide, but a growing number are increasing their lending activities to small businesses as shown by the following chart:



These facts clearly demonstrate that the "new breed" credit unions compete in all objective areas with tax-paying banks and thrifts – rate, product line, delivery systems, convenience and service quality.

V. <u>WHO BENEFITS FROM THE CREDIT UNION TAX SUBSIDIES?</u>

[15] http://www.weokie.org/bussinessloansie.html

Virtually all credit unions say publicly that they are organized to benefit their customers by saving them money from lower fees, higher rates on savings and lower loan rates.[16] But a recent survey has shown that, in fact, credit unions generally are not using their tax exempt status for the benefit of their borrowers or their depositors.[17] Rather, they are keeping their retained earnings to build capital on a tax-free basis, in order to foster their growth.

The report showed that the credit unions surveyed on average charge higher interest on loans to their members than do banks and thrifts. On average they also pay less on deposits and charge higher service fees (as a percent of total assets) than do banks and thrifts. The report also showed that the credit unions surveyed derived greater income through interest margin and deposit fees from their customers than banks and thrifts derive from their customer base.

In Oklahoma, for example, just a random comparison of rates paid on certificates of deposit in the Tulsa market shows the following comparisons:

$10,000 – bank rates	***$10,000 – credit union rates***	
6 Months – 1 – 1.5%	Tulsa Teachers	1.54%
	Tulsa Fed. Emp.	1.59%
	Oklahoma Central	1.302%
12 Months – 1.1 – 2.15%	Tulsa Teachers	1.59%
	Tulsa Fed. Emp.	1.64%
	Oklahoma Central	1.490%
18-24 Months – 1.45% - 2.70%	Tulsa Teachers	N/A
	Tulsa Fed. Emp.	2.43%
	Oklahoma Central	2.159%
36 Months – 2.12 – 270%	Tulsa Teachers	2.87%
	Tulsa Fed. Emp.	2.97%
	Oklahoma Central	1.697%

[16] *See, e.g.,* http://www.tinkerfcu.org/Membership/DefenseFund.html: "The banking industry would reduce your choice of financial institutions to one – a bank – if they could. That's because credit unions consistently save their members money – up to $500 a year, according to the Credit Union National Association. The savings come from *lower fees, higher rates on savings and lower loan rates.* Those savings we offer, in turn, set the pricing standard for consumer financial services, and banks don't like that." (emphasis added).

[17] *See* Kentucky Bankers Association *"Credit Union Study",* April 1, 2004, prepared by Financial Management Consulting Group, Louisville, KY 40243.: In comparing consumer loans reflected on banks' Uniform Bank Performance Report for June 30, 2003, the average yield on loans to individuals ranged from 8.39 to 8.89 percent for banks, and the same average for credit unions was 8.52 percent.

60 Months – 2.6 – 3.25%	Tulsa Teachers	N/A
	Tulsa Fed. Emp.	N/A
	Oklahoma Central	3.008%

These comparisons are virtually identical in other markets across Oklahoma in which the larger, new breed of credit union competes with tax-paying banks and thrifts.

A. A LOOK AT TODAY'S AVERAGE CREDIT UNION CUSTOMER

Another myth that has been perpetuated at the expense of the American and Oklahoma taxpayer is that credit unions serve people of modest means. However, the truth is that the typical credit union customer today is not a person typically associated with needing taxpayer-subsidized financial services. According to a recent CUNA survey, the average household income of credit union members is 20 percent higher than nonmembers - $55,120 vs. $45,790.[18]

Moreover, today's credit union customer is better educated (32 percent college graduates compared to 22 percent for nonmembers) and is more likely to be in a professional occupation or employed full-time (62 percent compared to 46 percent for nonmembers).

Credit union customers are more likely to own their own home (79 percent to 67 percent for nonmembers) and nationally about 10 percent of credit union members have household income in excess of $100,000. These statistics clearly show that upper-income households are over-represented and lower income groups are under-represented among credit union members.

Recent HMDA statistics for the year 2002 are revealing and indicative of the lending patterns of these larger credit unions. The reports show the disposition of applications for conventional home purchase loans that involve 1 – 4 family homes, by characteristics of census tracts in which the property is located.

The top three "new breed" credit unions in Oklahoma show the following statistics on conventional home purchase applications for 2002:

[18] CUNA National Member Survey, 2002.

Tinker Federal Credit Union – Oklahoma City

Income characteristics	Applications	Originations	Apps App'/Not Accepted.	W/D-Denied
Low Income	3	3	0	0
Moderate Income	28	15	4	9
Middle Income	123	85	25	8
Upper Income	149	102	28	14

Tulsa Teachers Credit Union - Tulsa

Income characteristics	Applications	Originations	Apps App'd/Not Accepted.	W/D-Denied
Low Income	0	0	0	0
Moderate Income	6	4	0	2
Middle Income	27	21	0	6
Upper Income	28	23	0	5

Weokie Credit Union – Oklahoma City

Income characteristics	Applications	Originations	Apps App'd/Not Accepted.	W/D-Denied
Low Income	6	4	0	2
Moderate Income	35	17	0	18
Middle Income	95	63	1	31
Upper Income	117	90	0	27

In reality, as these statistics demonstrate, this "new breed" of credit unions is more likely to serve middle and upper income Oklahomans, consumers that are already "over-served" by tax-paying banks and thrifts.

B. GENERAL ACCOUNTING OFFICE (GAO) FINDINGS

During his term as Chairman of the Senate Banking Committee, Senator Paul Sarbanes (D-MD) asked the General Accounting office to review a variety of issues involving the credit union industry and the NCUA. Its purpose was to evaluate the financial condition of the credit union industry, the extent to which credit unions serve people of small means, and the impact of the 1998 Credit Union Membership Access Act (CUMAA) on field of membership requirements for federal credit unions, among others.[19] The following are the highlights of the report released by the General Accounting Office in October, 2003:

> **Credit Unions with over $100 million in assets represented about 4 percent of all credit unions and 52 percent of total credit union assets in 1992 compared with about 11 percent of all credit unions and 75 percent of total credit union assets in 2002.[20]**

(By comparison in Oklahoma, the twelve largest credit unions noted above make up about 13 percent of all credit unions in Oklahoma and about 77 percent of total credit union assets in 2003.)

The GAO study reported additional findings that are worthy of note:

- **Large "new breed" credit unions resemble like-sized banks, and offer essentially the same products and services.**

- **Credit unions are failing their social mandate to serve people of modest means. According to the Federal Reserve's 2001 Survey of Consumer Finances, 36 percent of households that primarily or only used credit unions had low or moderate incomes compared with 42 percent of households that used banks. HMDA 2001 records show that credit unions made a smaller percentage of mortgages to low- and moderate-income households than banks of comparable size – 27 percent v. 34 percent.**

- **The income of credit union members is similar to that of bank and thrift customers.**

- **The Credit Union Membership Access Act (CUMAA) of 1998 greatly expanded the ability of credit unions to expand on a geographical basis[21] and permitted multiple common bond entities**

[19] Letter to the Honorable Paul Sarbanes from the General Accounting Office, October 27, 2003.
[20] *Id. At 4.*
[21] The percent of federal credit unions that have changed to a community charter has expanded rapidly since 1998 – from 6.2 percent to almost 15 percent by June, 2003. Moreover, NCUA is ignoring the CUMAA statutory requirement that the community be "local" – In 1999, the average size "community" approved by NCUA had a population of 134,000. In June, 2003, that number had grown to 357,000. Wescom Credit

– like Tinker FCU – to add "underserved" areas to its list of potential customers. However, the NCUA has failed to develop any indicators of whether credit union services are reaching the "underserved."

 While credit unions continue to hold a larger percentage of consumer loans than banks and thrifts, their real estate lending activities have grown dramatically in the past 10 years, growing from 19 percent to 26 percent. Consumer loans grew from 30 percent to 31 percent of all credit union loans during that same 10-year period.[22]

C. UNDERSERVED COMMUNITIES – A LOOPHOLE FOR EXPANSION

Another area of concern to taxpayers – one that constitutes more evidence that the new breed of credit union is abusing the tax code to expand its reach – deals with adding "underserved communities" to existing fields of membership.

All federal credit unions have the authority to include communities that satisfy the definition of "underserved area" in the Federal Credit Union Act.[23] In addition, more than one federal credit union can serve the same area that's designated as "underserved."

While the intent of such a provision is laudable, the manner in which the requirements have been implemented by NCUA makes a mockery of this well-intentioned provision. It assumes that "underserved" financially equates with measures of income below the poverty rate, without looking at the reality of the marketplace. As a practical matter this authority has been abused at the expense of taxpayers in Ada and other communities by expanding service to areas that, by virtually any logical definition, are not "underserved."

But logic has nothing to do with the expansionist agenda of the NCUA. Here's how it works: The Federal Credit Union Act identifies an "underserved" area as a local community, or neighborhood, or rural district

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Union's FOM, for example, includes 16 *million people* living in Los Angeles and four other counties in Southern California. At least five of Oklahoma's "Top Twelve" have a field of membership that includes approximately two-thirds of the state's population.

[22] Report of the General Accounting Office, October, 2003, GAO-04-92-Changes in Credit Union Industry, page 12.

[23] 12 U.S.C. § 1759(c) (2).

that is located in an "investment area" as defined by the Community Development Banking and Financial Institutions Act of 1994,[24] if it meets other requirements which, coincidentally, are established by the NCUA.

The NCUA's definition of such an area includes the following categories:

- Any area located in an Empowerment Zone or Enterprise Zone as designated according to statute or the Internal Revenue Code;
- Any area where the percentage of the population living in poverty is at least 20 percent *and the area has significant unmet needs for loans or equity investments*;
- Any area in a MSA where the median family income is at or below 80 percent of the MSA median family income by zip code and census tract or the national MSA family income, whichever is greater; *and the area has significant unmet needs for loans or equity investments;*
- Any area that's outside of a MSA where the median family income is at or below 80 percent of the statewide non-MSA median family income by zip code and census tract (or the national non-MSA median family income, whichever is greater) *and the area has "significant unmet needs for loans or equity investments*."
- Any area where the unemployment rate is at least 1.5 times the national average, *and the area has "significant unmet needs for loans or equity investments*."

Ada is located in Pontotoc County (total population 35,200) and hosts among its local financial institutions three commercial banks based in the community, each of which has a branch location. In addition to those six locations, there are two branches of banks whose primary location is in another community, and one branch of a federal thrift headquartered in Nebraska. In addition to these nine bank and thrift locations, there are two credit unions headquartered in Ada as well as nine different brokerage offices.

That makes a total of 20 financial services outlets in this basically "white collar" community of 16,000. Yet under the definitions listed above, Tinker FCU was able to construct an application that the NCUA interpreted as falling within the eligibility requirements for an "underserved" community. As a result, Tinker was permitted to add this area of Pontotoc County to its field of membership.

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[24] 12 U.S.C. § 4702 (16).

VI. TAXATION ISSUES: COOPERATIVE STATUS AND SUBCHAPTER S

Credit union advocates have long argued that they are simple financial "not-for-profit" cooperatives serving a narrow band of people and, as such, their exemption from an array of taxes continues to be justified. While that may be true for the vast majority of traditional credit unions, the new breed of credit union changes the landscape and requires policy makers to look at the historical treatment Congress has imposed on other cooperatively-based entities.

Initially, it's important to recognize that "not-for-profit" is a tax status. It is not a way of doing business. What the Congress gives, the Congress can take away, depending on whether the basic facts underlying the initial determination have changed.

A number of business entities were originally exempt from taxation, but Congress recognized that times changed as did the business reality of those entities. Mutual insurance companies, for example, were exempt from taxation prior to 1942. In that year Congress re-examined that status and concluded that such entities with annual gross receipts in excess of $75,000 should be subject to federal income tax.

Other entities similar to today's banks and thrifts – mutual savings banks, savings and loan associations, and certain farm credit system entities – were all exempt from taxation at one point. In 1951, Congress changed its view and revoked that exemption, concluding that it was no longer appropriate. The basis for that decision was a recognition that those businesses had "evolved" to the point where they were actively competitive with tax-paying institutions.[25]

In analyzing the changes that had occurred between 1917 and 1951, Congress concluded that cooperative banks, mutual savings banks and savings and loan associations had become something other than the entity for which the tax exemption was originally granted. Their "investing members (were) becoming simply depositors, while borrowing members (found that) dealing (with such entities was) only technically different from dealing with other mortgage lending institutions in which the lending group is distinct from the

[25] See generally S. Rep. 781, 82nd Cong., 1st Sess. (1951) reprinted in the U.S. Congressional & Administrative News, 1951, pp. 1991-97.

borrowing group. . ." Congress concluded that these entities were in "active competition" with taxable institutions, and that continuing their tax exemption would be "discriminatory."[26]

Subchapter T of the Internal Revenue Code currently imposes income tax on most cooperatives that are organized for economic purposes (as opposed to those organized for charitable or other limited purposes). There are numerous examples of such "economic purpose" cooperatives, such as Sunkist (the largest fruit and vegetable cooperative with 6,000 members), Southern States Cooperative (300,000 members) REI (a consumer cooperative serving more than 2 million members), and a host of other cooperatives.

Credit union advocates frequently argue that banks have the same tax benefit under Subchapter S of the Internal Revenue Code that is given to credit unions, and that since there are more than 100 Subchapter S banks in Oklahoma it is hypocritical for banks to now assert that any credit union should be taxed. Nothing could be further from the truth.

The critical difference between the "new breed" credit union tax dodge and Subchapter S treatment is that, in the latter instance, someone pays the taxes on the income that's earned – regardless of whether it's distributed.[27] That is not true with credit unions.

The tax treatment of new breed credit unions and Subchapter S banks would be the same if credit unions distributed all their earnings. They do not. Rather, earnings are used to ***build capital on a tax-free basis*** and, thus, enhance credit union growth.

No other entity in America is given such an advantage.

VII. CONCLUSION

At some point reality overcomes the shibboleths and myths that have been perpetuated over time, based on original purposes, outdated statistics and outright misrepresentations. When that happens, policy makers must confront hard realities and review the facts as they are, based on the reality of the marketplace.

[26] *Id.*

[27] There are other differences, not the least of which are the complex and restrictive rules that govern Subchapter S election. Only a small number of (community) banks with a limited number of shareholders are able to qualify for a Subchapter S election.

For eighty-one of the state's ninety-three credit unions, their traditional mission continues to be generally in line with their original purpose, and bankers across the board have no dispute with such entities. But the "new breed" of credit union has gone well beyond the original mission and purpose for which credit unions were created. They represent an aberration in the tax treatment of financial service providers, and policy makers at all levels must now look at whether the tax exemptions for this new breed of credit union continue to be justified

Precisely ***where*** the line of demarcation should be drawn between traditional credit unions and those that have graduated to another category is open to debate, but there can no longer be an honest debate over *whether* such a line must be drawn.

Clinging to the refrain that "it's still 1937" and "credit unions are small financial cooperatives" ignores today's reality in the financial services marketplace. If policy makers continue to ignore that reality, all taxpayers will continue to fill the void that exists because these entities are allowed to continue abusing their preferred tax and regulatory status.

These entities will keep pretending to be something they are not for as long as policy makers are willing to accommodate them. As a result, taxpayers will continue to subsidize their growth and expansion, without any discernable benefit to anyone except credit union managers. They will continue to get away with the ruse and avoid contributing anything to help pay for Homeland Security, the national defense, or for our teachers, police and firefighters. As a matter of public policy, that's simply wrong.

Moreover, by continuing to perpetuate these outdated myths, this "new breed" of credit union presents a systemic risk to the financial services system and the American taxpayer. Over time it will continue to move business away from the economic engine that has kept America strong – and paid taxes (commercial banks and thrifts) – to an industry that does not. The risks to taxpayers will only increase.

The issue that's presented is simple: at what point does reality overtake the myth? At what point do traditional credit unions graduate to a higher form of financial services entity and pay their fair share of taxes to support our nation and our state? And at what point do policy makers and elected officials take the necessary steps to reduce the threat of the systemic risk to the entire financial services system? That is a debate that must be engaged, sooner rather than later.