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Multiple-Group Federal Credit Unions: An Update

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Summary

Multiple-group federal credit unions (FCU) and litigation challenging the structure and membership in these FCUs have been the focus of much media attention and congressional concern. On February 25, 1998, the U.S. Supreme Court ruled in favor of the banking industry, invalidating the NCUA's policy regarding multiple-group fields of membership. The court case is the most recent effort by the banking industry in an ongoing battle. Bankers claim that credit unions have outgrown their founding principles and no longer deserve the competitive advantages of federal tax exemption and less stringent regulatory procedures. On April 1, 1998 the House passed credit union legislation, H.R. 1151. The legislation would grandfather all current FCUs and all current credit union members. In addition, the bill provides for future multiple-group formations subject to limitations that the NCUA must consider when authorizing charters. On April 30, 1998, the Senate Banking Committee passed H.R. 1151 with amendments. The Senate version contains provisions for stricter supervisory and commercial lending requirements.¹

Introduction

The current dispute evolved from a policy adopted in 1982 by the federal regulator for credit unions, the National Credit Union Administration (NCUA). In 1982, the NCUA issued an interpretive ruling and policy statement that provided flexibility to the field of membership requirements for federal credit unions. Credit union charters are granted on the basis of a "common bond". The common bond for establishing a credit union may be occupational, associational, or community. This requirement (found in the Federal Credit Union Act of 1934) determines the field of membership and is unique among depository financial institutions. The NCUA's interpretation permits membership in a FCU to consist of more than one distinct group so long as each group has its own common bond. The

¹ This report will be updated periodically to reflect developing issues and major legislative events. For current information about pending legislation please consult the Legislative Information System (LIS) at <http://www.Congress.Gov>.

NCUA's action was taken in response to changing economic conditions and as part of an industry commitment to meet the needs of individuals seeking credit union service.

The banking industry charged the NCUA's ruling permits unauthorized membership extensions. Bankers have accused credit unions of straying far from their founding principles of cooperative institutions. They claim that the industry's unique status among financial institutions needs to be re-examined.

In 1990, the American Bankers Association and several small North Carolina banks filed a lawsuit contesting the NCUA's approval of multiple group field of membership expansion for the AT&T Family Federal Credit Union. In July 1996, the U.S. Court of Appeals for the District of Columbia overturned a lower court's decision and ruled that "all members of a federal credit union must share one common bond." Currently, under the terms of several subsequent orders, FCUs cannot add new groups to their fields of membership, but the institutions are permitted to enroll new members into those established groups already being served.

On February 24, 1997, the U.S. Supreme Court agreed to hear the credit union case. The court heard arguments on October 6, 1997. The Justices spent most of the time focused on whether the banks were the appropriate parties to challenge a regulation that was not addressed to them. On February 25, 1998, the Supreme Court ruled that federal occupation-based credit unions must consist of an occupational group having a single common bond. The majority also held that the banks had legal standing to mount a court challenge to the NCUA.²

The 105th Congress has been monitoring the developments in the case and the ongoing controversy. An oversight hearing was held on February 26, 1997, to provide all sides with an initial opportunity to discuss the issues. Bills addressing the issues concerning the credit union common-bond field-of-membership policy were introduced but not enacted.

After the Supreme Court ruling, the House Banking Committee focused on drafting a bill that would provide a fair solution for credit unions and consumers while ensuring a policy of safety and soundness for the industry. The final draft was unanimously approved on March 26, 1998, as a substitute version of H.R. 1151 (H.Rept. 105-472). On April 1 the House passed H.R. 1151 by a 411-8 vote.

The major provisions of the bill include provisions to grandfather all current common bond arrangements and all current credit union members. Multi-group FCUs would be permitted in the future, but groups would be restricted to 3,000 members under most circumstances. The legislation would instruct the NCUA to consider discretionary limitations when chartering credit unions. In addition, NCUA rules on loans to members for business purposes would be frozen for one year pending a study. The legislation would

² For more information on the litigation and the Supreme Court decision see: U.S. Library of Congress. Congressional Research Service. *Multiple Group Credit Unions: Litigation and Potential Legislative Responses*, by M. Maureen Murphy. Washington, December 11, 1996. p. 15; and, *NCUA v. First National Bank & Trust Co. — U.S. — (No. 96-843): Credit Union Common Bond Ruling*, by Maureen Murphy. Washington, February 26, 1998. p. 2.

require all credit unions to have a “continuing and affirmative obligation to meet the financial service needs of people of low and moderate income.” Finally, the bill would require the NCUA to promulgate rules regarding several issues of safety and soundness.

On April 30, 1998, the Senate Banking Committee passed H.R. 1151 with Committee revisions that would impose stricter supervisory requirements on credit unions and place limits on commercial lending. In addition the Senate version of H R. 1151 would make it easier for credit unions to convert to mutual thrifts. Finally the bill would require the Treasury to conduct two studies. The first would compare the differences between the regulation of credit unions and other depository financial institutions including credit union tax treatment. The second would study ways to assist small banks, including reducing their taxes.

Background on the Credit Union Industry

Credit unions differ from other depository financial institutions because of their cooperative framework and unique charter requirements. The original concept of a credit union was a cooperative organization formed for the purpose of promoting thrift among its members and providing them with a source of low-cost credit. Credit union charters are granted by federal or state governments. Federal charters have been available since 1934 when the Federal Credit Union Act (FCUA) was passed. All credit union charters are granted on the basis of a “common bond”; this requirement determines the field of membership, and is unique among depository financial institutions.

The FCUA outlines three categories of common bond: occupational, associational, and community. The NCUA has established guidelines and policies for the three. An occupational group is defined as employment by the same enterprise. The associational membership is an organization, participation in whose activities develops common loyalties, mutual benefits, and mutual interests. The community common bond bases members on persons who live or work within a well defined neighborhood, community, or rural district. Individual credit unions are owned by their membership. Members’ savings are referred to as “shares,” and earn dividends instead of interest.

Because credit unions are considered financial cooperatives, the institutions are exempt from federal income tax. Individual members are taxed on their dividends.

Credit union loan and investment powers are more restrictive than commercial banks. Credit unions can only make loans to their members, to other credit unions, and to credit union organizations. Generally, the loan maturities cannot exceed twelve years. Credit unions can make 30-year mortgage loans subject to the rules and regulations of the NCUA. Credit unions can invest in government or government-guaranteed financial instruments.

The federal regulator, the NCUA, is an independent government agency. A three-member board, appointed by the President with the advice and consent of the Senate, manages the agency. NCUA is responsible for chartering, insuring, and examining federal credit unions. State regulators have primary supervisory authority over federally insured state-chartered credit unions. They work in cooperation with the NCUA to ensure that these institutions meet safety and soundness standards.

The federal insurance fund for credit unions, the National Credit Union Share Insurance Fund (NCUSIF), is managed by the NCUA Board. Membership in the NCUSIF is mandatory for federal credit unions. In some states, federal deposit insurance is optional for state-chartered credit unions. Over 95% of total credit union assets are held by federally insured institutions.

Year-end 1996, there were 7,152 FCUs and 4,240 state credit unions. Total assets held by credit unions are \$327 billion. By comparison, total assets held by all commercial banks are \$4.6 trillion. Commercial banks can also be federally or state-chartered. Year-end 1996, there were 2,726 national (federal charter) banks and 6,802 state-chartered commercial banks.

Multiple-Group Charters

In 1982, the NCUA issued an interpretive ruling and policy statement that modified the agency's FCU field of membership and chartering policy. This action and the subsequent amendments address multiple-group charters. These credit unions have fields of membership made up of related groups with one common bond or unrelated groups each having its own common bond. The groups may be occupational, associational, or a combination. The NCUA adopted this policy to provide the industry with the flexibility needed to respond to the distressed situations caused by economic conditions. In addition, the NCUA wanted to ensure that all groups seeking credit services could gain access.

The viability of many individual credit unions was threatened by the economic climate of the late 1970s and early 1980s. The United States experienced industrial slumps, the downsizing of companies, and plant closings. At the same time, there were a growing number of small service-oriented businesses that sought access to credit union services that did not meet the threshold for a charter of 500 employees.

The broader fields of membership obtained through multiple-group FCUs brought opportunities to individual credit unions and the industry as a whole. The NCUA regulations helped institutions avoid involuntary liquidation as a result of plant closings. Multiple-group FCUs expanded the access to credit union services. This worked for small member groups and also low-income consumers living in communities lacking access to financial services. The larger fields of membership provided economic stability and addressed the safety and soundness concerns associated with small memberships. In addition, multiple-group charters enhanced the credit union industry's ability to compete with other types of depository financial institutions.

By June 1996, almost half of the 7,244 FCUs had multiple-group fields of membership. These federal credit unions collectively included 158,000 different groups and have a total membership of 32.6 million. The multiple-group FCUs hold 79% (\$132 billion) of total FCU shares (deposits) and 78% (\$94 billion) of total FCU loans. The AT&T Family FCU was chartered in 1952. The credit union applied for charter amendments to expand its field of membership when the company (AT&T) was broken

up and downsized in the 1980s. Currently, this FCU includes 191 groups with approximately 111,000 members. Most of the groups are small businesses.³

Concerns and Policy Issues

Consideration of credit union legislation has generated heated debate involving several major policy issues. One area of concern is the connection between the original concept of credit unions (cooperative organization formed for the purpose of promoting thrift among their members and providing them with a source of low-cost credit) and the operations of credit unions today. Can the credit union industry still make a valid case for “uniqueness” among depository financial institutions? Bankers argue today’s credit unions operate more like banks, and the expansion through multiple-group charters significantly aids the blurring of lines between the two. Credit unions can offer a variety of financial services and consumer loans. In addition, their tax exempt status permits them to offer higher deposit interest rates and lower loan rates. Community bankers in direct competition say their banks operate under stiffer government regulations and are at a disadvantage.

Credit union representatives agree that industry growth has resulted in more competition between banks and credit unions. Their position is that this is healthy and helps consumers. Credit unions state that there are still significant differences between the two types of institutions. Credit unions are still cooperative organizations serving only their members. The institutions operate under more restrictive loan and investment powers. They point out the banking industry is constantly working to increase permissible lines of business and to streamline regulatory requirements. In general, current financial modernization legislation would increase bank powers but does not affect credit unions.

Another area of debate involves the importance of credit unions operating in low-income or underserved areas. Credit unions argue field-of-membership expansions through multiple-group operations have been crucial to industry efforts to meet the financial needs of low-income consumers. Bankers argue their industry has also made significant steps to reach out to this population. In addition, they argue credit unions’ claims of service to the poor do not justify unauthorized membership expansions.

An issue familiar to Congress is that of maintaining a “level playing field” through legislation. A segment of the banking industry (community banks), along with thrift institutions, are often in direct competition with credit unions for customers. Bankers state the advantages extended to credit unions today are based on concepts that are now outdated. Those advantages now give credit unions an unfair competitive edge. Credit unions disagree, stating that their founding principles are still intact, and the regulatory flexibility provided by the NCUA allows the industry to remain competitive and to continue to serve those seeking credit union membership. If Congress finds an imbalance, it may curtail credit union growth or it may choose to provide regulatory or other incentives to enhance the competitive positions of community banks and thrift institutions.

³ The source of all data was the NCUA.

Legislation in the 105th Congress

The 105th Congress is being pressured by both the banking and credit union industries to legislate solutions to controversies arising from competition between the two. The banking industry wants measures with provisions to federally tax credit unions, and desires also to stop the industry growth achieved by multiple-group FCUs. Credit union representatives have proposed legislative language to amend the Federal Credit Union Act to leave no doubt concerning the FCU fields of membership including multiple groups. Congress has acknowledged the conundrum, generally conceding that any debate on the issues will be quite heated. The Supreme Court decision has increased the pressure on Congress to deal legislatively with the issue of credit union membership.

Several bills were introduced during the first session of the 105th Congress and oversight hearings were held. The credit union industry backed H.R. 1151 (LaTourette and Kanjorski) a bill that would effectively codify the NCUA's policy regarding multiple-group fields of membership. H.R. 1151 gained over 200 co-sponsors.

Intense negotiations, after the February 1998 Supreme Court ruling, resulted in an amended draft of H.R. 1151. The new version of H.R. 1151 was passed by the House on April 1, 1998. The legislation grandfathers existing credit union membership and multiple-group FCU arrangements. A 3,000 person membership restriction would be placed on most new groups seeking multiple-group charters. The legislation addresses several issues of safety and soundness by instructing the NCUA to promulgate regulations. Current NCUA rules on commercial loans would be frozen for one year. The bill would require credit unions to meet the financial service needs of low and moderate income persons within their field of membership.

On April 30, 1998, the Senate Banking Committee passed a version of H.R. 1151 identical to the House-passed measure in most respects. The Senate amendments included the prompt corrective action provisions for the NCUA that were suggested by the Treasury Department. The Senate version would make it easier for credit unions to convert to mutual thrifts. Finally, two Treasury studies are mandated. The first would look at the tax treatment and regulation of credit unions compared to other financial institutions. The second would study ways to assist small banks including reducing their taxes.