ICBA
One Mission. Community Banks.

ICBA Talking Points on Credit Unions

HEADLINES

- Credit unions are violating the limits established by Congress to justify their tax exemption.
- Credit union acquisitions of community banks diminish tax revenues, consolidate the industry though tax subsidies, grow the publicly subsidized sector of the financial services industry, and increase the portion of the industry exempt from Community Reinvestment Act oversight.
- Congress should hold hearings to investigate the credit union tax exemption.
- Credit unions should not be able to use their tax subsidy to purchase taxpaying banks.
- Congress should impose an "exit fee" on credit unions' bank acquisitions to capture the tax revenue lost due to these transactions.

FACTS WITH NUMBERS

- The credit union tax exemption is contributing to the growing phenomenon of tax-subsidized credit unions buying taxpaying community banks.
- Credit union acquisitions of community banks and their branches have accelerated rapidly, with the past five years seeing approximately a 400% increase over the previous five years.
- The tax exemption allows credit unions to make inflated purchase offers well above the book value of acquired community banks.
- The credit union tax exemption dates to 1934, when Congress chartered credit unions as not-for-profit institutions to serve people of modest means with a "common bond" of occupation or association. But the tax exemption hasn't been updated since it was passed.
- While it took credit unions 106 years to hit the $1 trillion asset threshold in 2015, they needed just six years to double in size and pass $2 trillion in assets in 2021.
- ICBA polling of U.S. adults conducted by Morning Consult shows that Americans support reforming credit union policies. According to the polling:
    - 62% say credit unions that operate like banks should have to pay taxes like banks.
    - 62% say Congress should investigate whether the credit union industry's tax and regulatory exemptions are still warranted.
    - 59% say Congress should investigate whether credit unions should be able to acquire tax-paying community banks.
    - Just a quarter (26%) agree that credit unions should be able to use their tax savings to purchase expensive equipment for use by senior executives, such as private jets.

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- Just a third agree that credit unions should be able to use their tax savings to finance high-profile marketing expenditures, such as purchasing the naming rights to major sports stadiums (32%), or to raise funds from private institutional investors on Wall Street (34%).

a. Taxpayer impact

- Credit union purchases of community banks—which set a new single-year record in 2024—is an alarming trend because credit unions don't pay taxes, unlike their tax-paying community bank targets.

- While community banks contributed nearly $15 billion in tax revenue in 2022, the credit union industry enjoys a tax exemption worth an estimated $3-4 billion per year.

- The federal tax exemption for nearly $2.2 trillion in credit union assets continues to grow with each credit union-community bank acquisition because bank assets become tax exempt when bought by a credit union.

- The credit union tax exemption now subsidizes multi-million-dollar executive pay, lavish headquarters, and outsized marketing budgets, as exemplified by Northwest Federal Credit Union spending $8 million each year for the Washington Commanders football stadium naming rights.

b. Consumer impact

- These deals not only hamper tax revenue—they also restrict access to financial services.

- For instance, each acquisition increases the portion of the financial services industry exempt from the Community Reinvestment Act (CRA), which assesses whether financial institutions are meeting the needs of low- and moderate-income communities.

- While the CRA applies to community banks and virtually every other depository institution, credit unions are fully exempt.

- Further, the credit union industry's regulator—the National Credit Union Administration—continues expanding the powers of the industry it is charged with regulating without adequately examining compliance with consumer protection directives.

- Consumers receive fewer financial protections from tax-exempt credit unions than they do from tax-paying banks and lose protections when credit unions acquire banks, according to a top National Credit Union Administration official.

- According to a report from Washington Credit Union Daily, NCUA Office of Examination and Insurance Director Kelly Lay told agency Chairman Todd Harper that the different levels of consumer financial protection is a major difference between the industries.

- In a memo as part of the NCUA's response to a request by House Financial Services Committee Vice Chairman Rep. French Hill (R-Ark.) for information on credit union-bank acquisitions, Lay noted that the agency does not conduct separate periodic compliance

examinations or assign a separate consumer compliance rating to credit unions. “Therefore, the former bank customers that are now credit union members may have less consumer financial protection oversight after the bank-to-credit union transaction,” Lay said.

- The report follows recent remarks from Harper that worsening CAMELS ratings at large, complex credit unions means “a large and growing share of the credit union system’s assets reside in institutions with potential safety-and-soundness concerns that require immediate remediation.”

c. Underserved community impact

- Credit unions were established a century ago to serve people of modest means with a common bond, but the data show they are falling short of that mission.
- Today, less than 10% of credit unions are physically located in an economically distressed community and only 13% are in low- and moderate-income areas, according to ICBA research.
- Community banks outnumber credit unions by a 2-1 margin in low-income or distressed communities and are more likely to lend in census tracts with above-average poverty and unemployment, according to Home Mortgage Disclosure Act data.
- Moreover, HMDA data indicate that credit unions deny a higher proportion of minority borrowers for home loans than banks and charge higher prices on the ones they do accept.
- Meanwhile, the fallout a report on discriminatory lending at Navy Federal Credit Union continues with multiple congressional leaders seeking an inquiry.
- Policymakers have begun raising questions about the credit union industry’s exemption from the Community Reinvestment Act following the Navy Federal report and the first-ever Justice Department redlining settlement with a credit union.

d. Small-business impact

- With the nation’s community banks accounting for roughly 60% of U.S. small-business loans to local entrepreneurs and 80% of agriculture loans to local family farms and agricultural enterprises, each credit union acquisition displaces a critical and trusted provider of credit.
- The nation’s community banks account for roughly 60% of U.S. small-business loans and made 60% of federal Paycheck Protection Program loans to save an estimated 49 million jobs during the pandemic — outpacing credit union PPP lending by a factor of 16 to 1.

e. Consolidation impact

- Ultimately, credit union-community bank combinations further financial services consolidation, reducing the availability of locally based financial institutions in communities most in need of them.

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- And community banks aren't the only local institutions affected by this trend. Traditional credit unions themselves are declining as larger credit unions expand and account for more of the tax burden.

    - While credit unions in every asset category under $500 million continue to lose members and loans, credit unions over $1 billion comprise an increasing portion of the industry's assets and tax exemption.
    - Representatives of the smaller, community-based credit unions are questioning the tax exemption for the largest and most growth-oriented of these financial firms.

f. Transparency and accountability concerns

- Credit union acquisitions of taxpaying community banks lack transparency, with credit union executives using their members' savings to buy out bank owners in largely private deals.

- In fact, credit unions can leverage the savings from their tax exemption to make inflated offers for healthy community banks.

- The lack of transparency in how credit unions are using their member-owners' deposits also leads to less efficient financial institutions that squander their stakeholders' resources.

- Even while paying taxes that credit unions shirk, community banks are more efficient institutions that better serve stakeholders, raising questions about whether credit unions are allowed to rest on the laurels of their taxpayer-funded subsidies.

- Imagine the engine for economic growth community banks could be if they benefited from similar tax treatment, while credit unions are barely treading water from an efficiency standpoint, despite their sizable tax advantages.

g. Cyber concerns

- Credit union acquisitions are also concerning because the industry's regulator—the National Credit Union Administration—is not authorized to examine credit union third-party service providers for cyber risk.

- This means the NCUA does not have the same authority as bank regulators to supervise for cyber risk in the industry it is charged with regulating.

- NCUA Chairman Todd Harper has called the lack of authority a "regulatory blind spot" that means the agency doesn't "necessarily know what is happening" with credit union cybersecurity and could leave them as the "soft underbelly" of the broader financial system.

- He has separately said his agency's lack of oversight of credit union service organizations and other third-party providers is an "Achilles' heel" for the credit union system.

- Fortunately, bipartisan legislation would allow the NCUA to directly examine and regulate credit union service organizations, core providers, and other large third-party service providers.

- The Improving Cybersecurity of Credit Unions Act—introduced during the last Congress by Sens. Jon Ossoff (D-Ga.), Cynthia Lummis (R-Wyo.), and Mark Warner (D-Va.)—would ensure the NCUA has the same authority as bank regulators to supervise for cyber risk.

- The bill is supported by the NCUA's Harper and inspector general, the Government Accountability Office, the Financial Stability Oversight Council, and Senate Banking Committee Chairman Sherrod Brown (D-Ohio).

h. Wall Street concerns

- ICBA also is calling on the National Credit Union Administration to bar tax-exempt credit unions from using funds raised from Wall Street investors to finance acquisitions of tax-paying community banks.

- The credit union tax exemption should not be for sale to the highest bidder on Wall Street. The trend of growth-focused credit unions exploiting their federal tax exemption to raise funds from for-profit investors further entrenches the industry's tax and regulatory exemptions while increasing credit unions' debt burden, to the detriment of their member-owners.

- With modern credit unions abandoning their founding purpose to serve people of modest means — leaving the limits established by Congress to justify their federal tax exemption in the dust — policymakers must step in to address these perversions of increasingly antiquated federal policy.

- The NCUA should curb the abuse of its subordinated debt rule, which allows credit unions to use their tax exemption to raise money from private equity firms to acquire community banks. This means credit unions are selling ownership interests in their credit unions to nonmember investors, not their traditional member-owners.

- The rule led to an immediate explosion of subordinated debt issuance by credit unions, rising from $540 million in the second quarter of 2021 to $3.65 billion in the second quarter of 2023. This expansion of investment by for-profit firms has contributed to acquisitions of tax-paying Main Street community banks as a cottage industry of boutique investment banks and consultants has taken root.

- To address the negative impact of its subordinated debt rule on Main Street community banks, ICBA called on the NCUA to prohibit:
  - Any credit union that issues subordinated debt from participating in a merger or acquisition for the next five years.
  - Any credit union from issuing subordinated debt for five years after completing the acquisition of a community bank.

i. States leading momentum for policy review

- To counter the negative impact of these deals, policymakers in several states have begun responding.
  - Mississippi enacted a law requiring acquired bank assets to remain under the control of an FDIC-insured institution.

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- The Nebraska banking department separately ruled that only chartered financial institutions organized to do business in the state may participate in a cross-industry acquisition or merger — rejecting an attempted bank acquisition by an out-of-state credit union.
- A Tennessee judge in 2022 blocked a credit union bank acquisition after the Tennessee Department of Financial Institutions said the acquisition agreement is prohibited under state law.
- The Iowa Division of Banking in 2020 denied an acquisition, saying it would violate state law requiring that banks be sold to other banks, following a similar ruling by the Colorado State Banking Board.
- Further, Colorado state lawmakers voted down legislation to allow credit unions to hold municipal deposits and other public funds.
- Legislation in North Dakota to significantly expand the field of membership for the state's tax-exempt credit unions was voted down by the state's House of Representatives in 2023.

STORIES

- While many credit unions are virtually indistinguishable from taxpaying banks, the credit union industry's federal regulator—the National Credit Union Administration—continues finding new ways to increase the powers of the industry it is charged with regulating, calling into further question the justification for the tax exemption.

- The NCUA has allowed outside investors to profit from the credit union tax subsidy, repeatedly delayed capital requirements more than a decade after the financial crisis, and allowed credit unions to include wealthy suburbs of metropolitan areas in their fields of membership while leaving out their urban cores.

- Most recently, the NCUA has proposed deregulating for-profit companies owned by credit unions even though these companies are not supervised by the agency and are exempt from Federal Credit Union Act consumer protections.

- The NCUA has also repeatedly delayed implementing risk-based capital rules for large credit unions. In his dissent before taking over as NCUA chairman, board member Todd Harper noted that risk-based capital rules went into effect for banks years ago. "We are forgetting the past repeatedly, just like characters in Groundhog Day," he said.

- Harper has also said that some credit unions are "essentially eligible to anyone who wants to join them…" This expansion of the industry's field-of-membership standards contradicts the industry's founding mission.

- Harper also noted that the NCUA is the only financial services regulator that doesn't do a "deep dive" consumer compliance exam, which is increasingly important as credit unions consolidate, grow, and become more complex.

- Former NCUA Chairman and board member Mark McWatters has also admitted that the industry's fund insuring credit union deposits would be at risk without taxpayer subsidies.

RECOMMENDATIONS

- While states have started to respond, this is a matter of national importance, and taxpayers are entitled to know more about how the subsidy they fund is being used to underwrite financial services consolidation.
- With the number of credit union-bank acquisitions likely to continue increasing, ICBA is advocating an "exit fee" on these acquisitions to capture the value of the tax revenue that is lost once the business activity of the acquired bank becomes tax-exempt.
- Congress should also hold hearings to investigate the impact of this trend and the role of the credit union tax exemption and lax NCUA oversight.
- Congress should end the unwarranted federal tax subsidy of the credit union industry and/or promote increased tax parity between credit unions and community banks.
- Further, policymakers should apply Community Reinvestment Act requirements to credit unions comparable to and with the same asset-size distinctions as banks and thrifts, and states should prohibit the placement of public deposits in tax-exempt credit unions.
- There is precedent should Congress reconsider the credit union tax exemption. In 1951, Congress revoked the tax exemption for building and loan associations, cooperative banks, and mutual savings banks, finding that these institutions operated much like commercial banks and should be taxed accordingly.
- As policymakers work to support consumers, small businesses, and the taxpaying community banks that sustain local communities, their first stop should be reexamining the credit union tax exemption and NCUA's lax oversight.

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