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Viewpoint: NCUA Should Not Play a Charter Jailer

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The recent bankruptcy filing by Centrix Financial of Denver, the nation's largest credit union subprime lender, exemplifies the deep-seated pressures facing the credit union industry and underscores the importance of keeping the door open to conversions to the mutual savings association charter.

The filing was precipitated by the National Credit Union Administration's risk advisory this year against indirect auto lending by credit unions, and it came after the NCUA's April conservatorship of a $300 million Colorado credit union.

Dozens of credit unions -- some of which are billion-dollar institutions -- face losses running into the millions of dollars. These credit unions apparently felt they had to become aggressive indirect lenders to stay viable, even in a period of economic expansion when banks were booking record profits.

Meanwhile, using the pretext of consumer protection, the NCUA is planning to impose more red tape to slow mutual savings association conversions -- for the third time in as many years. When credit unions are forced by their charters' limitations to pursue risky, nontraditional sources of income, closing off the ability to exit the charter introduces systemic safety and soundness issues.

The Credit Union National Association, the industry's trade group, has itself described the credit union charter as subject to "severe limitations" on business lending and "stringent limitations on investment" and as "inflexible" on operations and governance.

Furthermore, the NCUA's anti-conversion policies violate federal law, and they contradict the sound public policy anchoring the U.S. banking industry -- the dual chartering system -- in which a depository institution is empowered to select the charter which best serves its mission. The NCUA's containment strategy inhibits free movement between charters and thwarts the competition among chartering agencies that promotes innovation and the efficient evolution of institutions.

The life cycle of many credit union products has expired. The payroll deduction and auto lending franchises that dominated for many years are threatened. Community charter expansions have not produced the membership and asset growth credit unions expected, and many are finding that they require something more to stay viable.

Contracting margins, rising operating costs, political pressure to reduce overdraft fees, declining interchange revenues, and pressure to be more responsive to low- and moderate-income populations are among the many forces affecting credit unions.

As might be expected, responses have varied. Many credit unions have liquidated their credit card portfolios to boost capital and book extra income as a short-term fix. Others are being aggressive to retard margin contraction by rapidly diversifying into higher-yielding real estate loans, commercial loans, third-party-originated auto loans, and across-the-country commercial loan participations. The percentage growth in these nontraditional products is in the double digits on credit union balance sheets, yet recent events prompt one to wonder whether the NCUA is learning to regulate the new risks at a double-digit rate.

At the end of 2005, more than 280 credit unions were classified Camels 4 or 5. They held 1.1% of credit union insured deposits, the highest numbers in a decade. Last year, 1,181 credit unions did not generate a positive rate of return. Despite their tax subsidy, 2,997 earned less than 40 basis points. Since 1969, the number of credit unions has plunged from 23,500 to 8,722 as of last December. Many expect the total to sink below 5,000 by the end of 2010.

Contrasting with the organization of more than 640 start-up banks and thrifts in the last five years, only 42 credit unions were organized in this period, and most were tiny community development credit unions with a social mandate.

Clearly, the NCUA needs to focus on supporting prosperous, full-service credit unions that want to stay credit unions, rather than spending its resources and political capital on trying to interfere with charter conversions.

Reorganization as a mutual savings association unlocks substantial additional lending ability because bank regulations and bank convention permit higher loan volumes per dollar of net worth. The additional investments that can be made, by way of new loans, let progressive conversion candidates better serve their communities.

Credit unions are handcuffed by punitive net worth requirements that affect their competitiveness as lenders. Also, credit unions are prohibited from tapping the capital markets to increase net worth, which would provide capital to support growth.

Switching to a thrift charter means giving up the state and federal income tax exemptions credit unions enjoy. Critics point to this as a disadvantage, without considering the revenue and profit growth that can be realized from broader market opportunity, product line, and capital access.

No meaningful regulatory relief is on the horizon for credit unions -- once again Congress will adjourn without doing anything about pending relief legislation, and most of the credit union industry's own leaders believe the tax exemption itself may eventually crumble. Despite NCUA's and state credit union regulators' attempts to improve the charter, we have seen many high-performing, well-managed credit unions decide that the mutual savings association charter would be more appropriate for their members and community.

Conversions present revenue challenges for a conflicted NCUA, which is both the regulator and insurer of credit union deposits. Nevertheless, blocking the exit door is poor public policy and may generate outcomes reminiscent of the savings and loan crisis. The NCUA's recent rulemaking illustrates that it cannot be trusted to administer the simple mandate issued by Congress in 1998 to promulgate rules for conversion voting that are "no more or less restrictive than those rules that apply to charter conversions by other financial institutions."

Congress wanted purely administrative rules from an objective regulator, at most. What it got was quite different. Because the NCUA, in partnership with the industry's trade associations, has been unable to improve credit union competitiveness, it is turning the charter into a prison by trying to lock the exits.

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