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Viewpoint: A Better Charter Alternative for Credit Unions

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For more than a decade my company, CU Financial Services, has been advising credit unions, especially those that moved aggressively into real estate and commercial lending, of the need to have access to third-party capital.

As it turns out, in 2010 it will become evident that the credit union industry is critically undercapitalized. Capital has been decimated across the board by the breadth of corporate failures.

The NCUA and independent analysts estimate that credit unions are facing losses in the $15 billion to $50 billion range. With only $90 billion in capital and stagnant earnings, recognizing these losses will dramatically limit the ability of the industry to serve its members and the community.

The industry business model, as envisioned by the NCUA, continues to require healthy credit unions to absorb the losses of the weaker. For many, this interdependence is conflicted and unfair. Consequently, numerous credit unions are considering converting from the credit union charter in order to avoid future assessments that could be as large as 5% of deposits. They also seek to gain other benefits from the larger, albeit also strained FDIC insurance fund. Most important, as we have long advocated, the bank charter carries with it access to outside capital markets.

Meanwhile, the NCUA, credit union trade associations and a number of credit unions are seeking congressional authority to access internal secondary capital. Their plan involves selling debt (counted as capital) to their credit union members. This is a terrible idea that any regulator should be against. No matter what the disclosures stipulate, members will think they are buying federally insured deposits. It's the Keating S&L case just waiting to happen again.

While acknowledging the important goal of the NCUA/industry capital proposal, I suggest a better alternative. Allow credit unions to convert to a bank charter without the regulatory red tape imposed by the NCUA.

In the past, the NCUA has demonstrated a lack of independence related to charter conversions. Many will recall that it invalidated the overwhelming vote in favor of conversion by two credit unions because of how a piece of paper was folded in the disclosure mailing.

The NCUA's numerous anticonversion practices illustrate that it cannot be trusted to administer the simple mandate issued by Congress in 1998 when it promulgated rules for conversion voting that "would be no more or less restrictive than those rules that apply to charter conversions of other financial institutions." Unfortunately, conversions present revenue challenges for a conflicted NCUA, which, like the former S&L regulator of the 1980s, is both the regulator and insurer of credit union deposits.

In conclusion, the question of long-term viability is what gets progressive managers looking at the bank charter. And, access to the capital markets may be critically linked to viability. Today, retained earnings alone won't sustain even the most conservative business plans or support the current level of assets and the declared missions of many credit unions.

Conversions will ameliorate the pressure on the credit union system to heal itself. The reality is that there is not and will not be sufficient self-generated capital (primary or secondary) to solve these problems without reducing all credit unions to the lowest common denominator. The expanded powers attendant to the banking charter will also allow institutions to better serve their members and the community as the economy recovers. Blocking the exit doors is poor public policy and is leading to outcomes also reminiscent of the S&L crisis.

Our regulated financial system is a system of charters, both state and federal, but also corporate and cooperative. We should think of credit unions not as an isolated industry, but in the context of the overall financial system. The free movement from charter to charter is a well-respected option for a bank. It should apply to a credit union as well.

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