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at the International Regulators Conference

Madison, Wisconsin

June 14, 1991

Good afternoon. I am extremely grateful to the World Council of Credit Unions, to Roger Jepsen and the National Credit Union Administration, and to the United States Agency for International Development for sponsoring this first international conference of regulators of credit unions. I feel very much at home with this group in this setting. First, because I, too, am a regulator, although I am a regulator of commercial banks and holding companies rather than credit unions. But that is a small difference. Second, because I am a member of the credit union of the Federal Reserve Board of Governors in Washington where my government salary is deposited directly into my account. Third, because I was born just 25 miles from here in Columbus, Wisconsin. In fact, my wife who was also born in Columbus obtained her degree from the University of Wisconsin here in Madison and taught English in a little town north of where we are meeting.

But those are only some of the reasons why I am especially pleased to be here with you today. More important is the fact that credit unions are increasingly important to the economies of nations all around the world. As any commercial or financial

activity grows in importance, it assumes more responsibility and becomes more politically vulnerable. In that context, credit unions everywhere will be challenged to be true to the purposes for which they were founded and the regulators of credit unions must make sure that growth is accomplished without compromising safety and soundness. The best way to insure the sound future of these special purpose financial institutions is for government regulators and the private sector credit unions they regulate to cooperate in a close working partnership for these common purposes. My remarks today will focus on the challenges ahead and how regulators can help the credit unions to meet them.

Although I am sure you are well informed about our United States credit union industry, I must confess that in pulling together some research for this speech, I was impressed by how much growth and change had taken place since the last time I took a close look. The importance of credit unions to the United States economy is self-evident when one realizes that the fifty-five million small savers who are the members of credit unions hold more than $180 billion of share interests. In recent years, credit unions have been quite profitable and those insured and supervised at the federal level by the National Credit Union Share Insurance Fund and the National Credit Union Administration have an excellent record for safety and soundness. There are nearly 12,800 federally insured credit unions in the United States. Capital stood at 7.6 percent of assets at year-end 1990 and they earned a .9 percent return on assets and 11.2 percent on

book capital. For 1990, those figures are significantly better than the ones for commercial banks.

For the past ten years, the growth rate of credit unions has been greater than for commercial banks, or savings and loans, or life insurance companies, or private pension funds. And over the same period, the credit unions with the strongest capital ratios have also been the most profitable, a particularly interesting fact for regulators to keep in mind.

In the United States, credit unions account for almost 13 percent of consumer installment credit. While that is only 27 percent of the amount represented by commercial banks, we need to remember that the assets of commercial banks are fifteen times greater than those of credit unions. This one illustration, alone, clearly demonstrates the importance of credit unions to the economy of the United States. They are both an important depository for small savers and an important source of credit for those same persons.

In the United States, the performance of credit unions in recent years has not only been characterized by stronger capital ratios and improved earnings but also by a general improvement in asset quality. Delinquent loans as a percentage of all loans has declined on a weighted average basis from 2.1 percent in 1985 to 1.7 percent in 1990. Over this same period, delinquencies in the same categories of loans in commercial banks and thrifts have generally been on the rise.

But my purpose here today is not to spread a euphoric glow over the audience. My purpose is to discuss the challenges that lie ahead for the credit union industry here in the United States.

A basic principle in the founding of the credit union movement in this country was the idea of a common bond among members. In most cases it has been common employment. In Boston, Massachusetts, for example, the telephone company employees formed and are members of a large credit union. And I have already referred to the credit union of the employees of the Federal Reserve Board in Washington.

But, in recent years there has been a decided drift toward broader interpretation of what constitutes a common bond. In moves to strengthen the industry, mergers of credit unions have been permitted after which the only common bond among the members of the merged institution is that they are members of the same credit union.

The most egregious violation of the common bond concept was attempted by the American Association of Retired Persons. In 1987 they chartered a credit union for their 19 million members whose only common bond was that they were retired. When the definition of common bond is that loosely interpreted, it becomes meaningless.

A second principle in founding credit unions was to provide convenient access for small savers to a safe place to save and to obtain consumer loans, typically for debt consolidation or big-

ticket consumer purchases such as appliances or automobiles. Thus short- and intermediate-term funding was matched to short- and intermediate-term lending, reducing interest rate and disintermediation risk.

During the 1980s, while funding remained short to intermediate term, lending practices changed markedly. More and more credit unions ventured into first mortgage lending with long maturities and fixed rates. In just the five years from 1985 to 1990, credit unions increased their real estate lending from under five percent of total assets to almost 22 percent. And this was done at a time when real estate markets were weakening. In the last two years, residential real estate values have declined as much as 25 percent in some parts of the country, suggesting that there may be asset quality problems ahead for at least some of the industry.

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What I am suggesting by these comments is that credit unions, at least in the United States, may be moving away from the fundamental principles upon which they were founded and toward becoming more like conventional thrift institutions or commercial banks.

In my opinion, these trends toward greater risk-taking and a much broader interpretation of the common bond requirements for membership pose a serious threat to the future of credit unions, at least in their present form.

As credit unions move to look more like commercial banks or conventional thrift institutions in terms of their asset structure, they will inevitably become more directly competitive with institutions chartered as commercial banks or thrift institutions and may become subject to all of the statutory and regulatory constraints which make life for those kinds of financial institutions so much more difficult.

At present there are exemptions for credit unions from federal taxation and the Community Reinvestment Act requirements which are among the more onerous burdens on commercial banks and thrifts. Those exemptions constitute significant competitive advantages for credit unions..

Naturally, those competitive advantages do not go unnoticed by banks and thrifts, and they are calling for legislation to redress the perceived disbalances. Such legislation action might impose a more rigid definition of common bond and limit loan activities to auto loans, equity credit lines, and consumer installment loans, Such limitations would be more in line with the traditional role of credit unions and tend to neutralize their competitive advantage. This approach would also be seen as limiting the exposure of credit unions to undue interest rate risk.

Another approach might be to remove tax exemptions presently enjoyed by credit unions and impose on credit unions the same requirements for reinvestment in their communities as those imposed on banks by the Community Reinvestment Act. This

approach would obviously bring about very significant changes in the management and cost structure of credit unions and drastically change their character and operating mode.

A more technical issue facing the industry is the nature and adequacy of its deposit insurance coverage through the National Credit Union Share Insurance Fund. And, a related issue is whether to mandate federal insurance for the 1,700 state-chartered and privately insured institutions. This latter issue took on greater urgency when the private insurer in the state of Rhode Island became insolvent and 35 institutions were closed. Many of the depositors in those credit unions still do not have access to their funds. The resulting jolt to an already weak state economy has underlined the possible weakness of private insurers and raised the question whether, in fact, all credit unions, regardless of state or federal charter, should be required to have federal insurance.

The question about the strength of the NCUSIF is not related to its balance sheet strength in relationship to recent loss experience, but rather to the liquidity available to it in case of need. It revolves around the ability of the fund to draw on the contributions of the individual credit unions which they in turn carry on their books as an asset.

Ten years ago the insurance fund was clearly in trouble. Total capital was only $175 million or about .3 percent of insured shares. But beginning in 1985 federally insured credit unions were required to make a contribution to the fund equal to

one percent of insured shares. At year-end the fund had total capital of $1.1 billion or 1.28 percent of insured shares, and it has since grown to $2.1 billion in 1990 and remained above 1.25 percent of insured shares.

The question which arises is how readily the fund could access the credit unions' contribution if the need arose since there may be some question about the legal authority of the fund to apply those contributions which are still carried on the books of the credit unions as an asset.

On another topic: Commercial banks and thrifts are required to publish figures related to their financial condition and make financial statements readily available to the public as well as shareholders. No such requirements apparently exist for even the largest credit unions. One could argue that shareowners in credit unions and the public are entitled to have available to them the financial statements of their credit unions prepared according to generally accepted accounting principles.

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These then are some of the issues facing credit unions in the United States today and they may be ones which are shared by credit unions in other countries as well.

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I am a firm believer that credit unions have an important place in the U.S. economy and that they should be encouraged to grow and flourish. But I think the future can only be assured if the issues I have raised are clearly recognized and firmly dealt

with by the managers of credit unions and the government regulators of the industry.

More specifically, I believe that regulators should hold credit unions to a narrower definition of common bond consistent with the original concept. I also believe that the long-run best interest of credit union regulators is the jealous protection of the safety and soundness of those institutions. To that end, limitation of interest rate risk and avoidance of risk concentration are imperatives. Credit unions should be encouraged to avoid undue concentrations in larger and longer term fixed rate assets such as first mortgage loans, which under frequent market conditions, may be illiquid.

The best defense of the industry's current exemptions from taxation and Community Reinvestment Act compliance is to continue to look like and operate like a credit union rather than a bank.

It is also important to eliminate any doubts about the soundness and capacity of the insurance fund. The Treasury has proposed expensing the contributions to the fund over a reasonable period of years and that appeals to me as a rational solution which would not impose great hardship on the industry. I would also urge that the regulators join with the industry in moving toward mandatory federal insurance for both state and federally chartered credit unions. I think public confidence in private insurers has been badly shaken by the Rhode Island episode and the ability of credit unions to attract new

shareowners in the future will depend on confidence in underlying insurance coverage.

Finally, I would urge credit union regulators to join with managers in publishing statements of credit unions on a regular basis for the benefit of shareowners and the public. Consideration might also be given to requiring independent outside auditors for the larger institutions in those cases where they are not presently being employed.

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If government will join with the credit union industry to address these and other issues as they arise, we can together build an even stronger and more useful financial resource for credit union members and forestall legislation which might change the fundamental character of the industry.

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