



2003

Can Credit Union Member Business Loans Meet the Need for More Credit to Small Businesses

Katherine E. Howell-Best

Follow this and additional works at: <http://scholarship.law.unc.edu/ncki>



Part of the [Banking and Finance Law Commons](#)

Recommended Citation

Katherine E. Howell-Best, *Can Credit Union Member Business Loans Meet the Need for More Credit to Small Businesses*, 7 N.C. BANKING INST. 405 (2003).

Available at: <http://scholarship.law.unc.edu/ncki/vol7/iss1/21>

This Comments is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Banking Institute by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

Can Credit Union Member Business Loans Meet the Need for More Credit to Small Businesses?

I. INTRODUCTION

Despite the sluggish economy, Em Knight's auto repair business, Kit Care, Inc., sped ahead. As owner, Ms. Knight determined that a new trailer would be an investment in the economic growth of her shop, but she needed a loan for the purchase. She visited her credit union in order to apply for the loan, the same credit union that provided her with the original financing of her auto repair shop. Since the opening of Kit Care, Ms. Knight continued her membership with the credit union, but over the years she began using a local bank to meet the company's financial services needs. However, frustrated by the cost of obtaining financial services from the bank, Ms. Knight returned to her credit union to obtain the trailer loan. Ms. Knight, remembering the ease with which she had obtained the loan in 1986 and taking into account her stellar credit history, assumed the credit union would promptly approve the loan. To Ms. Knight's dismay, credit union business lending is no longer that simple.

This Note discusses credit union member business lending regulations and considers the effect of these regulations on the unique role of credit unions in the financial services industry. This Note first distinguishes credit unions from other financial services providers, such as banks and savings associations, by reviewing characteristics peculiar to the credit union industry.¹ Part II of the Note defines a credit union member business loan and gives a brief regulatory history of member business lending.² In Part III, the Note focuses on the complexity of credit union member business lending regulations.³ Part IV considers the effect of member business lending regulations on the ability of credit unions to serve

-
1. *See infra* notes 7-14 and accompanying text.
 2. *See infra* notes 15-29 and accompanying text.
 3. *See infra* notes 30-61 and accompanying text.

their members' business financial service needs and the significance of these limitations on the business lending role of credit unions in the financial services industry.⁴ In Part V, the Note offers potential strategies for capitalizing on member business lending and encourages credit unions to consider the potential growth available in this area.⁵ The Note concludes that, with a comprehensive understanding of member business lending and a strategic plan for managing member business services, credit unions are in a prime position to fulfill small business needs and that the very existence of unmet financial services needs for these businesses supports the argument that credit unions do not pose a serious threat to banks' dominant position in the financial services industry.⁶

II. CREDIT UNION CHARACTERISTICS

Credit unions are unique in their history and regulation. The original concept of the credit union industry was to provide low-cost credit and to promote savings among credit union members.⁷ As such, they are organized as democratic, mutual institutions with no stockholders.⁸ Therefore, the only capital that credit unions produce is through retained earnings over time.⁹ Credit unions are also non-profit institutions, which means that they do not pay taxes the way other financial services institutions

4. See *infra* notes 62-79 and accompanying text.

5. See *infra* notes 80-106 and accompanying text.

6. See *infra* notes 107-111 and accompanying text.

7. Pauline H. Smale, *Credit Union Membership Access Act: Background and Issues*, CRS Report for Congress, No. 98-933 E, at 1 (Congressional Research Service, Nov. 19, 1998).

8. See *id.* at 2. Credit unions are owned by their members, whose savings are referred to as "shares" and whose earnings are in the form of dividends, rather than interest. *Id.*

9. See UNITED STATES DEPARTMENT OF THE TREASURY, COMPARING CREDIT UNIONS WITH OTHER DEPOSITORY INSTITUTIONS, 1 (Jan. 2001), available at www.treas.gov/press/releases/docs/CUReg.doc (last visited Feb. 15 2003) [hereinafter FSI Study].

do.¹⁰ This tax exemption allows credit unions to offer lower interest rates on loans and higher interest on deposits.¹¹

While this tax exemption is an obvious advantage compared to other financial institutions that must pay taxes, credit unions are uniquely restricted in their ability to service the public's financial needs. Credit union regulations require that credit unions only serve their "members."¹² Membership is generally composed of customers who share a charter-specified "common bond."¹³ This has been a disadvantage to the credit union industry, though it has been relieved in recent years, albeit to the consternation of bank competitors.¹⁴

III. MEMBER BUSINESS LOANS

A. Definition

In general terms, a member business loan (MBL) is a loan made for a business purpose.¹⁵ Not all business purpose loans, however, are necessarily MBLs.¹⁶ As described below, the statutory definition of an MBL is narrower than simply a loan for a business purpose and is distinguished from a business purpose loan (BPL).¹⁷ In short, an MBL is a BPL, but a BPL is not always an

10. See Smale, *supra* note 7, at 2. Although credit unions are exempt from federal tax, members pay taxes on their dividends. *Id.*

11. See FSI Study, *supra* note 9, at 7.

12. See Smale, *supra* note 7, at 2. Regulations restrict credit unions from making loans to entities other than their members, other credit unions, and credit union organizations. *Id.*

13. See 12 U.S.C. § 1759 (2002). The field of membership is specified in Section 5 of a credit union's charter. See NAT'L CREDIT UNION ADMIN., CHARTERING AND FIELD OF MEMBERSHIP MANUAL 2-1 (rev. 2001), available at http://www.ncua.gov/ref/charter_manual/chartFOM.pdf. Although a credit union can amend its field of membership, the original requirements for chartering the credit union must be met. See *id.*

14. See generally Smale, *supra* note 7 (discussing the controversy over the Supreme Court's interpretation of the Federal Credit Union Act's field of membership requirements in *National Credit Union Administration v. First National Bank & Trust Co.*, 522 U.S. 479, 118 S. Ct. 927 (1998) and the subsequent legislative process that reflected the competition between the banking and credit union industries).

15. See 12 U.S.C. § 1757a(c)(1)(A) (2002); 12 C.F.R. § 723.1 (2002).

16. See *infra* note 17 and accompanying text.

17. See 58 Fed. Reg. 40,040 (July 27, 1993). A business purpose loan (BPL) is a

MBL.¹⁸ This distinction significantly affects the ability of credit unions to engage in extensive business lending with respect to business loans that do meet the statutory definition of MBLs.¹⁹

The Federal Credit Union Act (FCUA)²⁰ defines an MBL as, “any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate, or other business investment property or venture, or agricultural purpose,”²¹ but expressly excludes certain types of loans from this definition.²² The exceptions generally involve specific forms of fully secured, fully insured, or fully guaranteed loans.²³ The most significant exception applies to extensions of credit made to a borrower or an associated member who has been granted \$50,000 or less in such loans.²⁴

B. Purpose and History

Prior to 1987, neither the National Credit Union Administration (NCUA) nor Congress regulated credit union member business lending.²⁵ Following a series of credit union failures involving unsound business lending practices, the NCUA passed regulations that were intended to fortify the credit union system by restricting credit union lending power.²⁶ In 1987, the NCUA implemented regulations that targeted business lending because these types of loans accounted for approximately half of

loan made for a business-related purpose, but that does not meet the statutory definition of a member business loan (MBL). *Id.* Credit unions most commonly report these loans as consumer loans, mortgage loans, or “other loans.” *Id.*

18. *See id.*

19. *See infra* notes 30-61 and accompanying text.

20. *See* 12 U.S.C. § 1789(11) (2002). The NCUA is the federal agency that promulgates and enforces credit union regulation. *See id.*

21. *See* 12 U.S.C. § 1757a(c)(1)(A) (2002); 12 C.F.R. § 723.1 (2002).

22. *See* 12 U.S.C. § 1757a(c)(1)(B); 12 C.F.R. § 723.1(b).

23. *See* 12 U.S.C. § 1757a; 12 C.F.R. § 723.1.

24. *See* 12 U.S.C. § 1757a; 12 C.F.R. § 723.1.

25. *See* UNITED STATES DEPARTMENT OF THE TREASURY, CREDIT UNION MEMBER BUSINESS LENDING 9-10 (Jan. 2001), available at www.treas.gov/press/releases/docs/mblstudy.doc (last visited Feb. 15, 2003) [hereinafter MBL Study].

26. *See id.* at 9-10 (noting that over half of the credit union failures were heavy business lenders, which caused directly and indirectly a loss of \$20-30 million to the NCUSIF); *see also* 51 Fed. Reg. 23,234 (Jun. 26, 1986) (discussing the rationale behind the proposed rule to regulate MBLs).

the National Credit Union Share Insurance Fund's (NCUSIF) losses for the years 1984 and 1985 and were anticipated to reach the same level in 1986.²⁷ The NCUA recognized that the limited role credit unions traditionally played in the business lending market meant that credit unions were likely to be inexperienced in underwriting and servicing business loans.²⁸ According to the NCUA, this inexperience, combined with desperation for a more competitive position in an ailing financial services industry, posed a serious risk to the credit union system and the NCUSIF.²⁹

IV. COMPLEX MEMBER BUSINESS LENDING

A. Primary Rules for Member Business Lending

Since 1987, the NCUA has modified its regulations governing business lending.³⁰ In 1998, as part of a larger legislative pursuit, Congress codified the NCUA's definition of member business lending and added lending and loan limitations.³¹ The Credit Union Membership Access Act of 1998 (CUMAA) restricted credit union member business lending to the lesser of either 1.75 times net worth or 12.25% of total assets,³² which the NCUA incorporated into its regulations in 1999.³³ NCUA regulations also limited outstanding MBLs to one member or group of associated members to a maximum of 15% of the credit union's net worth or \$100,000, whichever is greater.³⁴

27. See 51 Fed. Reg. 23,234 (June 26, 1986) (noting the important aspects of MBL regulation as it pertains to the current discussion).

28. See *id.*

29. See MBL Study, *supra* note 25, at 9.

30. See, e.g., 58 Fed. Reg. 40,040 (July 27, 1993); see also MBL Study, *supra* note 25, at 10 (noting continued imprudent business lending practices).

31. See *National Credit Union Administration v. First National Bank & Trust Co.*, 522 U.S. 479, 118 S. Ct. 927 (1998). The CUMAA upheld the Supreme Court decision in that it ruled against a credit union's expansion of its field of membership. *Id.* at 522. The CUMAA's codification of the MBL definition might be seen as a tradeoff for expanded field of membership authority. See generally FSI Study, *supra* note 9 (analyzing the relative positions of credit unions, banks, and savings associations in the financial services industry).

32. See 12 U.S.C. §§ 1757a(a), 1790d (2002); 12 C.F.R. § 723.16 (2002).

33. See 64 Fed. Reg. 28,721 (May 27, 1999); 12 C.F.R. §§ 723.16, 723.17.

34. 12 C.F.R. § 723.8.

In addition to the statutory and regulatory caps placed on business loans, the NCUA promulgated regulations requiring credit unions that engage in business lending to develop specific business loan policies that the NCUA believed would reduce the risk to the credit union system and the NCUSIF.³⁵ These policies, which must be reviewed annually by the credit union's board, are required to address issues such as personnel qualifications and experience (personnel involved in business lending must have at least two years experience with business lending), analysis and documentation of a borrower's ability to repay the loan, loan monitoring and servicing procedures, and identification of individuals ineligible to receive MBLs.³⁶ Thus, the NCUA sought to curb excessive risk-taking and preserve the safety and soundness of the credit union system by enacting both lending caps and specific business lending policies.³⁷

B. Exceptions to the Rules

The FCUA's definition of MBLs clarifies which extensions of credit are subject to statutory limitations on member business lending by credit unions.³⁸ The exemptions from the MBL definition reflect Congress's determination that certain types of fully secured, fully insured, fully guaranteed, or small loans (totaling \$50,000 or less to one member-borrower) do not threaten the safety and soundness of the federal credit union system, and thus should not be subject to the same limitations applicable to MBLs.³⁹ The question is whether, in light of these limitations, exemptions, and policies, credit unions can effectively meet the demand for business loans.⁴⁰ The answer to this question requires a business lending analysis unique to credit unions.

35. *Id.* § 723.5; *see also id.* § 723.6 (listing the minimum requirements for business loan policies).

36. *See id.* § 723.6.

37. *See infra* notes 38-50 and accompanying text.

38. *See* MBL study, *supra* note 25, at 11.

39. *See id.* at 35 (noting that every outstanding MBL could default, and the NCUSIF would remain solvent).

40. *See generally* FSI Study, *supra* note 9 (considering the competitive advantage and disadvantages of the various financial institutions).

C. MBL Determination

First, a credit union must determine whether it qualifies for a regulatory exception to the aggregate limit.⁴¹ A credit union that falls within one of three exceptions can avoid this limit.⁴² The three exceptions are: (1) credit unions that have low-income designation or participate in the Community Development Financial Institutions program; (2) credit unions that provide documentation that they were purposely chartered for making MBLs; and (3) credit unions that show historical evidence of engaging primarily in MBLs (evidenced by call reports filed between January 1995 and September 1998 that show 25% of the credit union's outstanding loans were MBLs or that the largest portion of the credit union's loan portfolio came from MBLs).⁴³ An NCUA regulation also permits the NCUA Board to exempt federally insured state chartered credit unions in a given state from the MBL rule if the NCUA approves the substitution of the state's rule.⁴⁴ Because safety and soundness considerations guide the NCUA Board's decision, the state regulation must minimize risk and accomplish the objectives of the NCUA's MBL rule.⁴⁵

For credit unions that are not exempt from MBL regulations, the next step is to determine whether the loan in question qualifies as an MBL. In Ms. Knight's case, perhaps the easiest place to start the analysis would be to determine the amount of the loan she sought. If the loan for which she were applying were less than \$50,000, then the loan would be defined as a BPL and not subject to the MBL restrictions.⁴⁶ The credit union must be careful, though, to aggregate loans to one borrower for this purpose.⁴⁷ Therefore, if Ms. Knight had obtained other business financing from the same credit union that had not been exempted from the MBL definition, then the previous loans and

41. See MBL Study, *supra* note 25, at 31.

42. See 12 U.S.C. §§ 1757a (b)(1), (b)(2) (2002).

43. 12 C.F.R. § 723.17 (2002).

44. See *id.* § 723.20.

45. See *id.*

46. See *supra* note 17 and accompanying text.

47. See 12 U.S.C. § 1757a; 12 C.F.R. § 723.1.

the new loan would be aggregated.⁴⁸ If the aggregate amount exceeded \$50,000, then the credit union would be dealing with an MBL, even if the new loan itself were less than \$50,000.⁴⁹ If the loan exceeded \$50,000, whether by aggregation or by itself, the credit union would have to determine if it might be excluded from the MBL definition on other grounds.⁵⁰

D. Considerations Following an MBL Determination

If the credit union is dealing with an MBL, it must consider several factors. Credit union MBLs must be granted on a fully secured basis by first and second liens, up to 80% of the loan-to-value ratio.⁵¹ Loans must be guaranteed with the personal liability of the principal.⁵² Loans to one borrower⁵³ may not exceed 15% of a credit union's net worth, or \$100,000.⁵⁴ MBLs must be granted for periods consistent with the "purpose, security, and creditworthiness of the borrower, and sound lending practices."⁵⁵ Finally, credit unions must reserve "allowance for loan losses" at 100% of the outstanding loan amount for actual losses, 50% for "doubtful loans," and 10% for "substandard loans."⁵⁶

48. See 12 U.S.C. § 1757a; 12 C.F.R. § 723.1.

49. See Aggregate Limits on Member Business Loans (MBLs), NCUA Opinion Letter 02-0384, http://www.ncua.gov/ref/opinion_letters/2002/02/0384.html (May 30, 2002).

50. See *supra* notes 38-43 and accompanying text.

51. See 12 C.F.R. § 723.7. "[F]irst liens between eighty to ninety-five percent loan to value may be acceptable when the amount exceeding eighty percent is fully insured by a private mortgage insurer." MBL Study, *supra* note 25, at 12 (citing 12 C.F.R. § 723.7).

52. See *id.*

53. See *id.*

54. See *id.* The 15% limit is calculated by adding the outstanding balance of MBLs to any one member (or group of associated members) and then subtracting any portions that are: (1) secured by shares in the credit unions; (2) secured by deposits in another financial institution; (3) insured or guaranteed fully or partially by federal or state agencies or political subdivisions; and (4) purchased by advance commitment by an agency of Government. See 12 C.F.R. § 723.9.

55. See MBL Study, *supra* note 25, at 12; 12 C.F.R. § 723; 12 U.S.C. § 1757(5) (2002). This statute prohibits terms on most types of loans made by credit union from exceeding twelve years. See 12 U.S.C. § 1757(5).

56. 12 C.F.R. § 723.

E. Aggregation of all MBLs

Credit unions must aggregate MBLs to individual borrowers, and also must aggregate all MBLs granted.⁵⁷ Once a credit union decides that it would like to grant an MBL, it must determine whether it has reached its overall aggregate limit in granting MBLs,⁵⁸ which is the lesser of 1.75 times the credit union's net worth (retained earnings) or 12.25% of the credit union's total assets.⁵⁹ If the credit union determines that the loan will not violate the aggregate limit on MBLs, and the aforementioned conditions are met, then the credit union may grant the loan.⁶⁰ The issue then becomes whether the credit union wants to grant the loan.⁶¹

V. MEETING FINANCIAL SERVICES NEEDS

A. Credit Unions and the Business/Commercial Services Market

Recall that when the NCUA first promulgated rules to restrict member business lending in 1987, credit unions engaged in very little commercial lending.⁶² However, the small amounts of commercial lending caused substantial losses to the NCUSIF and undermined the integrity of the credit union system.⁶³ Since then, the number of credit unions providing MBLs has increased, although credit unions are still minor participants in the business

57. See 12 U.S.C. § 1757.

58. See *supra* notes 45-50 and accompanying text.

59. See 12 U.S.C. §§ 1757a(a), 1790d; 12 C.F.R. § 723.16.

60. See *supra* notes 38-59 and accompanying text.

61. See Frank J. Diekmann, *Sharpening Your Pencil: More of What CUs Need to Know Before Plunging Into the MBL Market*, CREDIT UNION JOURNAL, at 10 (May 13, 2002), available at 2002 WL 9725158. The article criticized MBL regulations because of the problems credit unions have with turning away good member loans because the credit union has too many other good loans. See *id.*

62. See 51 Fed. Reg. 23,234 (June 26, 1986) (reporting that a vast majority of federal credit unions did not engage in member business lending, and that it did not expect that to change).

63. See *id.* In fact, the NCUA could have assumed that regulating business lending would only improve the credit union system by protecting the NCUSIF. See *id.*

lending market.⁶⁴ As of June 30, 2000, only 14% of credit unions reported outstanding MBLs,⁶⁵ which translates into 1.5% of the commercial lending market.⁶⁶

A survey of the credit union industry indicates growth in the business lending market.⁶⁷ For example, aggregate member business lending went from \$2 billion as of year-end 1993 to \$4.3 billion as of mid-year 2000, an increase of 115%.⁶⁸ The number of credit unions with outstanding MBLs went from 1,390 in 1993 to 1,493 in 1999, a 7% increase.⁶⁹ Other factors in the economy indicate the potential for the expansion of business lending within the credit union industry, such as an ongoing economic downturn that has forced or inspired individuals to pursue independent business pursuits, sending such entrepreneurs to financial services providers for capital and business needs.⁷⁰ Since credit unions historically provide low-cost credit, higher returns, and personalized service, such individuals might find credit unions the most desirable financial services provider. Reports from the Credit Union National Association's (CUNA) Credit Union Small Business Summit suggest that the Bush Administration considers the credit union industry a "valuable means of expanding access to credit for new and small business owners because of [its] closeness to the markets."⁷¹

How significant are small business financial services to the financial services industry? Small business is the world's third largest economy, and continues to grow by 1,200 new small businesses daily.⁷² In the United States, the 26 million small

64. See MBL Study, *supra* note 25, at 1.

65. See *id.*

66. See Laura K. Thompson, *Credit Unions Up Their Small-Biz Lending*, AM. BANKER, Apr. 29, 2002, at 5. Credit union MBLs only comprise 1.5% of the business lending market, about the equivalent of a mid-size bank's portfolio. *Id.*

67. See MBL Study, *supra* note 25, at 1.

68. See *id.* at 34.

69. See *id.*

70. See Bob Hoel, *Business Lending & Services Opportunities* (providing a power point presentation that reviews credit union opportunities in the current economy), available at www.swcorp.org/Articles/Hoel-2002.ppt (last visited Feb. 15, 2003).

71. See Ed Roberts, *At 'Summit,' CUs Press for Expanded Business Lending*, CREDIT UNION J., at 1, (Apr. 22, 2002) (paraphrasing a top White House aide), available at 2002 WL 9725000.

72. See Mike Gaylord, *Small Business is Big*, INTEREST MAGAZINE (Sept. 2001)

businesses in operation (65% of which report less than \$250,000 in annual sales) employ 53% of the workforce, generate 50% of the GNP, and originate 55% of innovations.⁷³ Of these small businesses, 45% obtain loans for operations, 40% use lines of credit, and 27% get commercial mortgages and term loans.⁷⁴ Most of these businesses own commercial checking accounts, prefer centralized service, and prefer to handle personal and commercial financial transactions within the same financial institution.⁷⁵

B. Potential for Credit Unions in the Small Business Lending Market

The foregoing statistics, combined with an assertion by the Ohio Credit Union League (OCUL) that financial institutions lag in meeting capital needs ranging between \$50,000 and \$250,000, indicate that the small business market is primed for available, cost-effective, and convenient financial services.⁷⁶ Credit unions

at 6, available at <http://www.ohiocul.org/Interest.htm> (last visited Feb. 15, 2003) (on file with the N.C. Banking Institute).

73. *See id.*

74. *See id.*

75. *See id.*

76. *See generally* MBL Study, *supra* note 25; FSI Study, *supra* note 9. Credit unions historically have a tradition of serving low- and moderate-income clients, which might result in transferable experience useful in providing business services. *See* Gaylord, *supra* note 72 and accompanying text. Originally, the credit union was a cooperative organization that would be able to offer its members low-cost credit. Although credit unions have always been able to engage in commercial lending, its members have shown little demand. *See* MBL Study, *supra* note 25, at 5. However, the Department of Treasury anticipates an increase in member business lending in the wake of the CUMAA because of expanded membership potential and conversions to community charters, which specifically permit business membership. *See id.* at 4. The Act's business lending restrictions, coupled with the NCUA's risk-based net worth requirements, should temper growth, but the trend, nonetheless, indicates growth. *See id.*

The Department of Treasury's survey conducted pursuant to the MBL Study showed that 25% of MBLs were made to members with household income of less than \$30,000, and that these loans totaled 13% of the outstanding member business lending balances. *See id.* at 26-27. Another 20% of the loans (with 15% of the outstanding loan balance) went to households with incomes reported to be between \$30,000 and \$50,000." *See id.* This means that almost half of the MBLs are granted to low- and moderate-income members. *See id.* Credit unions, therefore, are potentially significant entities in meeting the financial needs of many low- and moderate-income individuals, and possibly small businesses. *See id.* When these individuals turn to their credit unions for financial services, the question becomes

have the potential to gain a competitive advantage in the field of financial services for small businesses.⁷⁷ The unmet need for small business lending presents credit unions that are particularly well suited⁷⁸ to fulfill this demand for financial services with an opportunity to enter the commercial lending market, which is a significant asset producer in the financial services market, especially for banks and thrifts.⁷⁹

VI. STRATEGIES AND CHALLENGES

A. *Strategies for Credit Unions Business Lending*

Business lending can be “the bread and butter of some financial institutions, a side interest for others—and a danger zone for those that aren’t properly staffed and prepared to assess and monitor the complex transactions.”⁸⁰ The Credit Union Executives Society (CUES) issued its recommendations for designing a member business lending strategy.⁸¹ CUES first emphasized the gap ranging from \$50,000 to \$250,000 of unmet “long-term equipment financing or short-term working capital needs.”⁸² According to CUES, this is a “profound member business services opportunity” that should be pursued through six key steps.⁸³

First, CUES suggests determining, through surveys or questioning, what percentage of a credit union’s membership is

whether credit union regulation might prevent the ability of these individuals and businesses to obtain low-cost loans. See Diekmann, *supra* note 61, at 10.

77. See *infra* notes 81-93 and accompanying text.

78. See *supra* note 77 and accompanying text.

79. See MBL Study, *supra* note 25, at 7 (noting that banks and thrifts had about \$1 trillion, or about 15% of total assets, in outstanding commercial loans as of mid-year 2000).

80. See Karen Bankston, *Piece of the Pie: Hands-on Commercial Lending Rounds Out a Product Line-up* (quoting Scott Chicoine, president of UW-Oshkosh Credit Union and former commercial banker), available at <http://www.cues.org/fyi/0400pieceofthepie.htm> (last visited Feb. 15, 2003).

81. See Michael Hales, *Member Business Lending Success Strategies*, CUES FYI, Sept. 16, 2002, available at <http://www.cues.org/fyi/n91602.htm> (last visited Feb. 15, 2003).

82. See *id.*

83. See *id.*

eligible for an MBL.⁸⁴ Second, a credit union should perform an “external market analysis” in order to determine the demographic composition of its small business market and with which financial institutions the credit union will have to compete for business.⁸⁵ Third, the credit union should become familiar with the NCUA’s MBL policy guidelines so that it may implement an MBL policy that satisfies the NCUA’s regulations, but that also corresponds to the particular objectives and design of the credit union.⁸⁶ Fourth, a credit union should offer MBLs and deposit services to small businesses if the first and second steps indicate potential in the market.⁸⁷ Fifth, a credit union should identify its target market and then tailor products and services to meet those needs.⁸⁸ Finally, a credit union should place credit analysis, whether from within or by outsourcing, in the hands of a qualified party.⁸⁹

The fourth step above may be the most significant because of credit unions’ advantages in servicing business accounts, such as the ability to pay dividends on business checking accounts.⁹⁰ According to the OCUL Service Corporation’s Member Business Services Task Force and the California Credit Union League’s MBS (Member Business Services) Study, the most important business service that credit unions provide their members is the business checking account.⁹¹ The business checking account may, in many instances, be a credit union’s initial relationship with a business member.⁹² These business checking accounts would consequently provide the basis for a business services relationship and generate core deposits.⁹³

84. *See id.*

85. *See id.*

86. *See id.*

87. *See id.*

88. *See id.*

89. *See id.*

90. *See* Dave Shoup, *Simple Checking and Savings Can Grow Into Many More Opportunities*, INTEREST MAGAZINE, Sept. 2001, at 5, available at <http://www.ohiocul.org/Interest.htm> (on file with the N.C. Banking Institute). Banks may not offer interest bearing business checking accounts. *See id.*

91. *See id.*

92. *See id.*

93. *See id.*

B. Challenges to Credit Union Business Lending

Despite the efforts to enter the business lending market, credit unions currently confront a regulatory structure that limits their ability to provide otherwise judicious credit. For example, some credit unions report turning away good MBLs because the credit union has granted too many other good business loans, and granting an additional MBL would cause the credit union to exceed its MBL limits.⁹⁴

Other challenges for credit unions relate to their membership requirement. The limited fields of membership prevent some small business borrowers from being able to obtain loans because the business is not a credit union member.⁹⁵ Until recently, the availability of the Small Business Administration's (SBA) principal loan program, which would be beneficial to credit unions that are trying to reach the smaller end of the business loan market (loans under \$100,000) because of the NCUA regulation that excludes from loan limits the portions of MBLs that are governmentally guaranteed, was considered too exclusive.⁹⁶ On February 14, 2003, the SBA amended its policy, mitigating this challenge, by allowing credit unions to "make SBA-backed loans as long as they do not discriminate within their fields of

94. See Diekmann, *supra* note 61, at 10.

95. See *supra* note 13 and accompanying text.

96. See Bankston, *supra* note 80. According to an article written after an interview with Scott Chicoine, president of UW-Oshkosh Credit Union, Bankston reported that

[t]he advantage of making loans with an SBA guarantee is that the credit union does not have to include those loans in its loan loss reserve category. Thus, the credit union can fund its loan loss at a lower level, improve profitability and assume less risk for the guaranteed loans.

Id. Credit unions may find some assistance in loan programs, such as the SBA's principal loan program or with company's like the National Cooperative Bank, a Washington company that specializes in lending to cooperative institutions. See Thompson, *supra* note 66, at 5. It recently began a lending program for credit unions, whose services are designed to meet credit union needs. *Id.*

membership.”⁹⁷ The effect of the SBA’s new policy remains to be determined.

Credit unions also face opposition from bank competitors. Efforts to improve the ability of credit unions to provide financial services have consistently been met with protest by the banking industry. For example, banks, thrifts and credit unions quibbled extensively over the Financial Services Regulatory Relief Act of 2002.⁹⁸ Although this legislation was designed to decrease the regulatory burdens on all the financial services industry sectors, all of the sectors came under criticism for arguing against relief for other sectors.⁹⁹ Banking interests, in particular, argued against the credit union provisions of the bill by emphasizing the potential for credit union encroachment into banks’ market share of financial services and by claiming that the credit union tax exemption continues to be an unfair competitive advantage for credit unions.¹⁰⁰

Banks allege that credit unions are creeping into the banking industry’s share of the business lending market.¹⁰¹ The empirical evidence, however, does not support this allegation.¹⁰² According to a Department of Treasury report, credit union member business lending almost doubled in seven years, from \$2 billion in 1993 to \$3.9 billion in 1999, while banks increased commercial and industrial lending by almost 85%, from \$447.8 billion in 1993 to \$824.7 billion in 1999.¹⁰³ In fact, the largest increase in business lending occurred among thrifts, with business lending increasing by 240% between 1993 and 1999.¹⁰⁴ Although

97. John Reosti, *SBA Makes More Room for Credit Unions*, AM. BANKER, Feb. 18, 2003, at 1. Prior to February 14, 2003, the SBA policy stated that its lenders must be “open to the public,” meaning that credit unions (other than those with community or low-income charters) may be too exclusive, due to their limited fields of membership, to qualify for the program. See Roberts, *supra* note 71, at 1.

98. See Financial Services Regulatory Relief Act of 2002, H.R. 3951, 107th Cong. (2002).

99. See Michele Heller, *House Lawmakers Hide Groups for In-Fighting*, AM. BANKER, Apr. 26, 2002, at 3.

100. See *id.*

101. See *id.*

102. See MBL Study, *supra* note 25, at 33-34.

103. See *id.*

104. See *id.*

banks had the least percentage growth, their market share continues to dominate business lending.¹⁰⁵ In light of these numbers, continued limitations on credit unions' customer base and lending ability, and the fact that the gap in the business lending market exists precisely where banks are failing to meet small business needs and credit unions are making most of their MBLs,¹⁰⁶ the assertion that banks are threatened by losing market share to credit unions seems unlikely.¹⁰⁷

VII. CONCLUSION

This Note considers the unique position of credit unions in the financial services industry to be a positive attribute. Credit unions might be the best financial institution available to certain individuals and segments of the population.¹⁰⁸ Although credit unions are relatively heavily regulated compared to other financial services institutions, these regulations do not necessarily impede credit union success.¹⁰⁹ Credit unions whose business lending goal is to allow members who need business lending services to make credit unions their primary financial institution should devise business lending and business services strategies.¹¹⁰ This includes offering business accounts, gaining experience that will enable the development of ancillary services, and, ultimately, mastering

105. *See id.*

106. *See generally* FSI Study, *supra* note 9. This potential is partly owed to the credit union tradition of serving low-and moderate-income individuals. *Id.* Out of this tradition has developed an atmosphere of friendly customer service and a philosophy of competitively priced products and services. *Id.* While large financial institutions concentrate on the larger business accounts as a strategy for maximizing earnings potential, reasonably priced and well designed small business financial products and services continue to be inadequate. *Id.* Combined with expanded opportunities for fields of membership, this situation presents an optimal means of access for credit unions into the business/commercial financial services market. *Id.*

107. *See generally* MBL Study, *supra* note 25; FSI Study, *supra* note 9 (comparing credit unions with other financial institutions and expecting the relative positions of each to remain the same).

108. *See supra* notes 81-93 and accompanying text.

109. *See, e.g.,* FSI Study, *supra* note 9 (considering the advantage and disadvantage of credit union regulation).

110. *See* Rose Bartolomucci, *Group Working to Develop Resources for Peers Who Want to Offer Member Business Services*, INTEREST MAGAZINE, Sept. 2001, at 7, available at <http://www.ohiocul.org/Interest.htm> (last visited Feb. 8, 2003) (on file with N.C. Banking Institute).

member business lending. Perhaps most importantly, though, credit unions must make their services and product lines known to their members in order to tap their unmet financial services needs.¹¹¹

KATHERINE E. HOWELL-BEST

111. See Bankston, *supra* note 80. "Marketing, assessing and monitoring commercial loans is a person-to-person process," and according to Scott Chicoine of UW-Oshkosh Credit Union, "you have to be hands-on" *Id.*

