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The Credit Union Regulatory Improvement Act
Frequently Asked Questions

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This paper provides a free market perspective on the Credit Union Regulatory Improvement Act (H.R. 1537, known as CURIA) as well as on a number of issues facing financial institutions that make loans and take deposits. The Act would take a variety of deregulatory steps with regard to America's credit unions. It would reduce, but not eliminate, differences in the way in which banks and credit unions are regulated. Although its legislative language is complex, CURIA would do three fundamental things:

1) Allow credit unions to serve a broader "field of membership," particularly in areas that have a shortage of credit union services. It would also clarify a number of existing field of membership rules and regulations in ways that would let credit unions expand their membership.
2) Allow credit unions to make more loans to businesses. Currently, credit unions cannot use more than 12.5 percent of assets for business loans. CURIA would let them use up to 20 percent.
3) Reduce the capital requirements to which credit unions are subject. Currently, credit unions must maintain 7 percent of their capital. CURIA would let them retain 6 percent.

By all accounts, CURIA consists of halfway measures. It touches most aspects of credit union operations, but it does not change the fundamentals of credit union regulation. It does not tighten credit union regulation in any significant way, but it offers far less deregulation than other reform proposals. While some elements of CURIA are worthwhile, it leaves many needed areas of reform unaddressed.

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Which are subject to more government regulations overall, credit unions or banks?

Credit Unions. For a variety of historical reasons, credit unions face more regulatory burdens than banks. Banks can serve anybody who walks through their doors, while credit unions have defined fields of membership, such as the employees of a particular company or the residents of a particular community. The government does not mandate to banks how much they can charge in interest, but regulates credit union interest rates very strictly. Credit unions also face restrictions on the amount of their assets they can lend to businesses.

Banks, however, do face some regulations that credit unions do not. As not-for-profit institutions, credit unions do not pay most federal taxes and may have exemptions from some types of state and local taxes. By contrast, most—though not all—types of banks do pay these taxes. In addition, the Community Reinvestment Act of 1977 (CRA)—which requires banks to follow government guidelines in lending to "underserved areas"—does not apply to credit unions at all.

Generally, banks want to remain banks and credit unions want to remain credit unions. A handful of credit unions have converted themselves into banks. Banks, likewise, can convert themselves to credit unions if they wish. Both types of conversions, however, imply costs to members and stockholders so they happen only infrequently.

CURIA, on balance, loosens restrictions on credit unions. Even if Congress passes CURIA exactly as written, however, credit unions would still remain far more regulated than banks.

Banking and consumer groups have called for a "level playing field" between credit unions and banks. Isn't it only fair to establish one?

Yes, but a level playing must take into account differences in the structure of lending institutions. Imposing the exact same restrictions on two types of institutions regardless of their structure would not create a level playing field. Banks and credit unions differ dramatically in their mission and in whom they serve. The current exemptions from certain regulations that credit unions enjoy stem from their non-profit status. Taxing credit unions would not level the playing field but would tilt it ever more toward the benefit of banks. Banks, like all other businesses, have the ability to pass their taxes onto others: their customers, stockholders, or employees. If banks feel that they pay unfair or burdensome taxes, they should lobby against their own taxation rather than trying to impose taxes on others. As written, CURIA would take a small step toward a more equitable competitive environment, but it would leave many problematic regulations in place.

Should the Community Reinvestment Act apply to credit unions?

No. But it should not apply to banks either. The Community Reinvestment Act attempts to prevent "redlining" and encourage lending institutions to serve all areas of the communities in which they operate. CRA does not apply to credit unions, because credit unions had even more severely limited fields of membership when CRA first went into effect, so it would have been nearly impossible for them to engage in redlining. Today, some credit unions have fields of membership that include entire states or large cities and, in theory, could engage in redlining—yet there is no evidence that any credit unions have done so.

More importantly, there is very little evidence that CRA has achieved its stated goals with regard to banks. If legislators want more credit union lending in low- and middle-income or minority neighborhoods, they would do better to make it easier for credit unions to enter those neighborhoods—something that CURIA would do.

Fundamentally, it *is* unfair that CRA applies to banks and thrifts—particularly smaller ones—but not community credit unions that may serve almost identical markets. As a way of leveling the playing field, Congress could improve CURIA by adding provisions to exempt smaller banks and thrifts from CRA. (Although it might just as well consider separate legislation for this purpose.)

Should we retain restrictions on whom credit unions serve?

Not via political means. Most tax exempt non-profits—even those that run in a business-like fashion—have few restrictions on whom they can serve. Many hospitals do not pay taxes but few people suggest that they should have a defined "field of service" to prevent them from competing with for-profit hospitals.

Credit union field of membership restrictions first came about for a good reason. Before credit bureaus kept information about all financially active individuals, community reputation served as the best way to determine a person's credit risk. In this environment, keeping any small financial institution going required that management have an intimate knowledge of borrowers. By limiting credit unions to affinity groups—typically people who worked, worshipped, or went to school in the same place—community ties could help to compel repayment of loans. Today, however, these community ties have little or no impact on credit union lending. Like all other financial institutions, credit unions rely heavily on credit scores in making lending decisions. They are no more—and no less—likely than banks to change lending rules based on personal connections or community reputation. Safety and soundness no longer provide a good rationale for continued political regulation of credit union membership.

On the other hand, plenty of credit unions engage in activities that might prove difficult to carry out on a larger scale. Others may simply value their small size.

CURIA would loosen, but not eliminate, restrictions on credit union fields of membership. Most credit unions would continue to serve well defined groups and no credit union would serve a field of membership larger than a state; CURIA would not allow national fields of membership.

Should credit unions and banks have different capital requirements?

Probably not. Capital requirements set the amount by which a financial institution's assets must exceed liabilities. All financial institutions have to retain some capital in order to remain solvent and protect themselves from unexpected losses. For financial institutions with federal deposit or share insurance—which nearly all banks and credit unions carry—capital protects the taxpayer from losses.

The more capital a credit union has to retain, the more net income it has to earn to remain in business, and the less quickly it can grow. Right now, credit unions must retain 7 percent of assets. CURIA would lower this to approximately 6 percent under generally accepted accounting principles and, for the most part, equalize bank and credit union standards for risk-based capital requirements. In an era when credit unions lacked diversification because they served very limited groups of people, higher capital requirements may have made sense because massive layoffs at a single employer could seriously compromise the ability of a credit union to function. Today, as credit unions have grown to serve more diverse memberships, they have become much more resilient.

Does CURIA go far enough?

No. The Credit Union Regulatory Improvement Act is a series of halfway measures based more on short-term political concerns than on any concerted effort to change the fundamental nature of America's regulatory structure for credit unions. While its proposals move towards a generally freer market, they do not level the playing field or end any regulations altogether. CURIA is only a small start. Over the long term, the nation should do a lot more to deregulate banks, credit unions, and all other financial institutions.