



# INCREASED COMPETITION:

## CREDIT UNION GROWTH CONCERNS BANKS

## MORE EXPANSION IS LIKELY

**W**hen Kip Unruh decided to re-finance one of his small businesses, Star Storage Inc. in Grandview, Mo., the first thing he did was shop for lenders.

“It was a million-dollar loan,” Unruh says. “So I did my homework.”

He began his search the way any small business owner would, by visiting a handful of area banks and comparing their rates and terms. In the end, though, his most attractive offer wasn’t from a bank but a local credit union—a business-lending option Unruh didn’t even realize he had until reading an article in a trade publication.

During the past few years, the once-inconspicuous credit unions have been expanding lending services and attracting

small business owners like Unruh.

Recently liberalized membership requirements and expanding lending services are spurring credit union growth—and increasing competition with banks, says Eric Robbins, a policy economist at the Federal Reserve Bank of Kansas City, who researched how regulatory changes have affected credit union growth in the Tenth Federal Reserve District.

“As credit unions have expanded their customer base, they also have been able to grow their deposits and assets more rapidly than banks,” Robbins says.

Credit unions say this expansion doesn’t infringe upon banks’ business, but increases competition. Banks argue that this is an encroachment aided by

unequal regulatory treatment. Both entities agree, however, that credit union membership will increase as a result.

“Although most credit unions are small, they still may provide significant competitive pressure for Tenth District banks, which also tend to be small,” Robbins says.

## Turning up the competition

In addition to home and auto loans, many Tenth District credit unions, such as Mazuma Credit Union in Kansas City, Mo., now are offering small business loans.

Although it’s “a shift in the way we do business,” it’s what many of their 51,000 members—and countless potential members—want, says Russ Dalke, Mazuma Credit Union vice president of finance.

“We’ve been hearing that for a few years,” Dalke says. “We thought, ‘Hey, we need to get on this.’”

As credit unions begin to compete with banks in small business lending, research shows banks are increasingly concerned about credit union growth. Almost half of the community banks in the Tenth District surveyed by the Federal Reserve Bank of Kansas City in 2004 said they expect “very intense” or “intense” loan competition from credit unions during the next five years.

“Banks may be concerned because credit unions are entering a segment of the lending market in which they were not previously involved,” Robbins says. “In addition, business lending by credit unions is increasing, and the small business loans provided by credit unions likely would have been obtained from a bank in the absence of credit union competition.”

While the percentage of business loans from credit unions tripled during the last four years, roughly 81 percent of federal- and state-chartered credit unions reported no business lending at the end of 2004, according to Robbins’ research.

For most community banks, business loans are an important part of their lending portfolios. Community banks (those with assets less than \$1 billion) account for about 37 percent of all small business lending. And these

loans are about 19 percent of community banks’ assets.

Although an increasing number of credit unions are pursuing business lending as a new source of income, the total lending by credit unions is still small compared to banks.

Still, Dalke acknowledges banks may feel threatened by credit unions’ expansion into small business lending, but thinks it’s



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**EARLIER THIS YEAR**, Kip Unruh (pictured left) obtained a loan for his storage facility from a credit union in Missouri. Many credit unions nationwide are expanding services and offering small business loans.

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unnecessary because credit unions are generally much smaller than banks. This is not a matter of one entity beating out another, but offering the customer more choices, he says.

“You would hope they (banks) would look at this as competition—that’s what capitalism is,” Dalke says. “I want them to view it as a challenge.”

Rob Gilbert, president of the Tulsa-based F&M Bank, says banks are certainly challenged by credit unions' growth. It's not just the expansion into small business lending, but the "uneven playing field" from which credit unions and banks compete for customers, he says.

"I truly believe we should all be on the same page," says Gilbert, who is also a member of the Board of Directors of the Federal Reserve Bank of Kansas City's Oklahoma City Branch.

Because they originated as nonprofits to serve those with modest means, credit unions have enjoyed exemption from most of the state and federal taxes that banks must pay. This means credit unions often are able to offer customers better deals than banks, such as fewer fees for services like ATM use and checking accounts.

Banks argue credit unions have deviated from their original mission but still reap the benefits enacted to support that mission.

"This notion of providing credit to those of small means as the primary purpose of credit unions has been a lightning rod to banks as credit unions expand lending and deposit services to a wider audience," Robbins says.

Unlike banks, there are no laws that require credit unions to prove whom they serve or in what capacity their members may be served. Credit unions aren't affected by the Community Reinvestment Act, which requires banking and thrift institutions to help meet the credit needs of their communities.

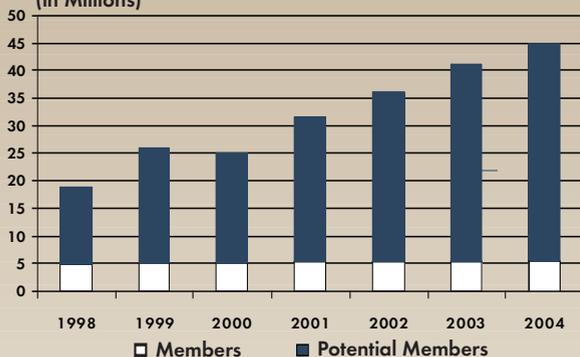
Furthermore, recently liberalized membership requirements have allowed credit unions to expand their membership. Banks charge that these regulatory differences further assist credit union growth as well as mission deviation.

In their early years, credit unions had a customer base more narrowly defined by membership. For example, federal credit unions were required to choose from three types of membership fields based on a common bond of association (such as fraternal or religious groups), occupation or community. These limitations were thought to be the best way to encourage borrowers to repay debts because of the common bond with other credit union members.

During the early 1980s, an increasing number of credit unions ran into financial difficulty, and in response, the government relaxed membership restrictions to help credit unions remain viable. The National Credit Union Administration, which regulates federal credit unions, altered the interpretation of common bond requirements to allow occupational and associational groups

### Tenth District Credit Union Membership

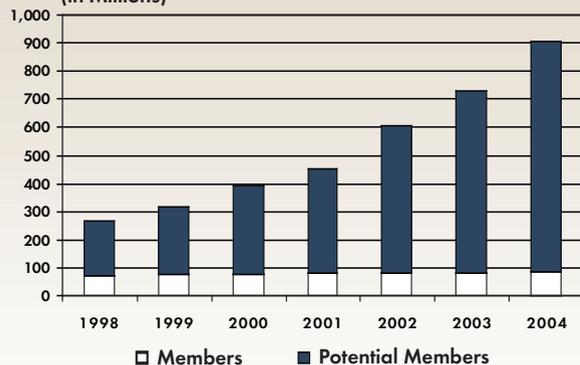
(in Millions)



The Tenth District includes: western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico

### Nationwide Credit Union Membership

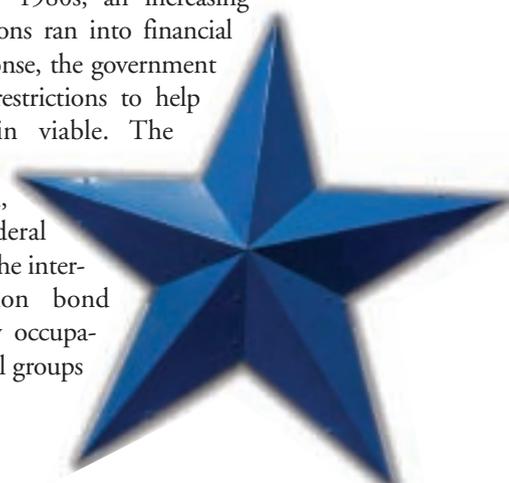
(in Millions)



SOURCE: NCUA 5300 Call Report Data

## The differences

When credit unions first migrated from Europe to the United States in the early 1900s, they were cooperatives that provided loans by pooling members' resources. The goal was to give credit to individuals who couldn't obtain financing through mainstream institutions.



## Credit Union Member Business Loans (in millions)

	Total Loans and Leases	Agricultural Loans	Total Business Loans	Business Loans as a Percent of Total Loans	Increase in Business Loans 2000-2005
<b>CREDIT UNIONS IN TENTH DISTRICT STATES</b>					
2000	19,384	47	130	0.7%	529%
2005	26,902	79	818	3.0%	
<b>ALL CREDIT UNIONS</b>					
2000	305,261	599	4,817	1.6%	299%
2005	467,608	999	19,215	4.1%	

SOURCE: NCUA 5300 Call Report Data

to combine under one federal credit union charter, known as a multiple common bond charter. As a result, credit unions could increase the number of potential members within their fields.

“While this expansion of membership fields may have resulted in the improved financial condition of credit unions,” Robbins says, “it also may have caused increased competition between banks and credit unions.”

Gilbert of F&M Bank says, “It’s just not right,” adding that credit union growth is assisted by these advantages, leaving banks to “just compete with them as best they can.”

Overall, credit unions’ earnings lag behind those of banks, despite these advantages, according to Robbins’ research. Also, credit unions do face restrictions that banks don’t.

Although membership definitions have broadened, they still are restrictive. Membership fields have been redefined, but federally chartered credit unions must still choose from among three types: single common bond (such as occupational), multiple common bond or community charter.

In addition, credit unions cannot issue stock to increase capital. Capital growth is achieved through retaining earnings from year to year. Also, credit unions’ total business lending portfolios cannot exceed 12.25 percent of their total assets.

### Expanding into the future

Increased business lending and membership growth may lead to continued expansion of the credit union industry. While credit unions have consolidated during the last sever-

al years, as have banks, credit union membership has increased overall.

Credit unions in the Tenth District reported 4.9 million members in 1998—the year membership restrictions were expanded to allow multiple common bond credit unions. By 2005, membership increased more than 10 percent to 5.4 million members. As credit unions have switched to more expansive fields of membership, the number of potential members has increased even more significantly—by 157 percent in the Tenth District.

Credit unions’ earnings generally appear to be less than banks’, and most credit unions are smaller in size. But, nationwide credit union asset and deposit growth is higher than banks’. During the last decade, credit unions’ asset and deposit growth increased by an annual compound rate of 8.4 percent and 8.1 percent, respectively. Commercial banks averaged 7.7 percent and 6.9 percent, respectively.

“Competition will likely continue to increase as more credit unions expand their fields of membership and enter the business lending market,” Robbins says.

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BY BRYE STEEVES, SENIOR WRITER

## FURTHER RESOURCES

CREDIT UNION GROWTH IN THE TENTH DISTRICT,

BY ERIC ROBBINS

[www.KansasCityFed.org/TEN](http://www.KansasCityFed.org/TEN)

**COMMENTS/QUESTIONS** are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org).