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The Post-2008 Lending Environment and the Need for Raising the Credit Union Member Business Lending Cap

Thomas Zells

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THE POST-2008 LENDING ENVIRONMENT AND THE NEED FOR RAISING THE CREDIT UNION MEMBER BUSINESS LENDING CAP

THOMAS ZELLS*

ABSTRACT

While the economy has gradually begun to improve following the 2008 Financial Crisis, “Main Street” has not played a large role in the recovery. This is atypical of most recoveries, and particularly disturbing because of the disproportionate number of jobs traditionally created by small businesses. Credit unions, but for the current statutorily imposed cap on their business lending authority, could substantially aid Main Street’s recovery. The cap currently restricts a credit union’s member business lending to 12.25 percent of its total assets and chills their ability to engage in business lending or to even invest in developing business lending programs at all.

This Note argues that raising this cap, as is suggested in proposed legislation such as the Credit Union Small Business Jobs Creation Act (H.R. 688), would significantly assist Main Street’s recovery by providing substantial new credit to small businesses, thus promoting the creation of new small businesses and jobs. This Note begins by providing a brief history of credit union member business lending and showing that not only is there no statutory reason for the current cap, but also that the proposed policy justifications at the time of its implementation were greatly overstated. It then explains how the current economic and regulatory environment, along with modern policy considerations, strongly support raising the cap. Finally, this Note shows how currently proposed legislation and agency support would largely alleviate concerns about the safety and soundness of individual credit unions, the credit union system, and the National Credit Union Share Insurance Fund as they relate to increased member business lending authority.

*J.D. Candidate, 2015, William & Mary Law School; B.S. Political Science and International Affairs, Florida State University, 2011. I would like to thank my incredible girlfriend, Jeannine, and my wonderful parents, John and Elizabeth, for their constant love, support, and encouragement throughout this process. I would also like to thank Michael D. Lozoff, Esq., for his continued mentorship and counsel, both as it relates to this Note and my continuing legal education. Finally, I would like to thank the members of the *William & Mary Business Law Review* for their hard work and assistance throughout the Note-writing process.

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INTRODUCTION

The 2008 Financial Crisis forever changed the financial landscape of the United States. The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) has imposed and continues to impose massive amounts of regulation¹—some needed and some arguably not—on all types of financial institutions, regardless of their role in causing the “Great Recession.”² The current economic and regulatory climate has created an environment in which job creation and economic stimulus require a much increased emphasis on more easily available credit to new and expanding small businesses.³ Credit unions have the potential to help provide this credit safely and with no added expense to taxpayers.⁴ Raising the current statutorily imposed member business lending cap, presently set at 12.25 percent of a credit union’s total assets,⁵ to 27.5 percent of total assets would have a substantial impact on the economy.⁶ This change to the lending cap is estimated to create 157,000 new jobs and add \$14 billion in loans in the first year alone.⁷

This Note argues that there was never a legitimate statutory reason for establishing the first ever member business lending cap, set at 12.25 percent of total assets.⁸ Instead, the limit was set arbitrarily.⁹ This Note further argues

¹ Mark Koba, *Dodd-Frank Act: CNBC Explains*, CNBC (May 11, 2012, 4:01 PM), <http://www.cnbc.com/id/47075854>, archived at <http://perma.cc/8LF2-5N89>.

² See *id.*

³ *Supporting Small Businesses and Creating Jobs*, THE WHITE HOUSE OFFICE OF MGMT. & BUDGET, <http://www.whitehouse.gov/omb/factsheet/supporting-small-businesses-and-creating-jobs>, archived at <http://perma.cc/F3CE-E9B3>.

⁴ See National Association of Federal Credit Unions, *Member Business Lending*, NAFCU.ORG, <http://www.nafcu.org/mb/> (last visited Mar. 26, 2015), archived at <http://perma.cc/J7EJ-2LV9> (“Removing or modifying the credit union member business lending cap would help provide economic stimulus without costing the taxpayer a dime.”).

⁵ Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)) (The cap requires that “no insured credit union may make any member business loan that would result in a total amount of such loans outstanding at that credit union at any one time equal to more than the lesser of—(1) 1.75 times the actual net worth of the credit union; or (2) 1.75 times the minimum net worth required under section 1790d(c)(1)(A) of this title for a credit union to be well capitalized.”); 12 U.S.C. § 1790d(c)(1)(A) (2012) (setting the minimum net worth ratio at 7 percent (1.75 times 7 percent is where the 12.25 percent cap comes from)).

⁶ See CUNA’S RESPONSE TO OBJECTIONS TO RAISING THE CREDIT UNION MEMBER BUSINESS LOAN CAP, CUNA RESEARCH AND POLICY ANALYSIS, at 3 (Sept. 26, 2012) [hereinafter CUNA], available at <http://perma.cc/N8D2-6X6E> (stating that raising the cap “will increase the efficiency of capital allocation in the economy,” and “promote more lending, more spending, more job creation and higher economic growth.”).

⁷ *Id.* at 3, 4.

⁸ This is not to say that a cap should be eliminated. While the cap’s initial creation is subject to much question and legal analysis, this Note does not undertake the question of whether

that the current economic climate and regulatory landscape strongly support raising the cap to 27.5 percent. The policy justifications, namely credit union and National Credit Union Share Insurance Fund (NCUSIF) safety and soundness concerns, which were relied upon in establishing the original cap, were never as compelling as they were made out to be and certainly need to be viewed differently in the dramatically different present financial landscape.¹⁰ The proffered motivations for the initial cap were never legitimate and, at the very least, should no longer exist.

This Note first briefly examines credit unions and the history of member business lending in Part I. Part II shows that there was never a legitimate statutory reason to have a member business lending cap at 12.25 percent. Part III shows that the policy reasons given for the cap's initial creation, namely concerns over the safety and soundness of credit unions and the NCUSIF, were not as convincing as they appeared. Part IV examines the lack of current policy justifications for maintaining the cap and will show that countervailing policy reasons support an increased cap. Finally, Part V delves into how safety and soundness concerns have been addressed and can be further addressed even with an increased cap, and examines proposed legislation that would adequately do so.

I. A HISTORY OF CREDIT UNIONS AND MEMBER BUSINESS LENDING

Credit unions first appeared in the United States in 1909¹¹ and became popular as alternative financial institutions and sources of credit.¹² They

full abolishment of the member business lending cap is warranted. This Note also does not argue that strong regulatory restrictions on credit union business lending are unneeded.

⁹ 105 Cong. Rec. S9007 (daily ed. July 27, 1998) (statement of Sen. Chuck Hagel), *available at* <http://www.gpo.gov/fdsys/pkg/CREC-1998-07-27/html/CREC-1998-07-27-pt1-PgS9006-3.htm>, *archived at* <http://perma.cc/FX5G-LPGH> (stating that “[t]he 12.25 percent of assets commercial lending cap now in H.R. 1151 is completely arbitrary”). It must be noted that he was arguing for an even lower cap. The statement merely evidences the cap's arbitrary nature. *Id.*

¹⁰ See *Where are We Now? Examining the Post-Recession Small Business Lending Environment*, 113th Cong. 3 (2013) (testimony of John Farmakides, President/CEO of Lafayette Federal Credit Union, on behalf of the National Association of Federal Credit Unions); William J. Clinton, Statement of Administration Policy: H.R. 1151—Credit Union Membership Access Act (July 22, 1998), *available at* <http://www.presidency.ucsb.edu/ws/?pid=74369>, *archived at* <http://perma.cc/635T-V9LL>; see generally 105 Cong. Rec. S9007 (daily ed. July 27, 1998) (statements of Sen. Chuck Hagel and Sen. Bennett), *available at* <http://www.gpo.gov/fdsys/pkg/CREC-1998-07-27/html/CREC-1998-07-27-pt1-PgS9006-3.htm>, *archived at* <http://perma.cc/FX5G-LPGH>.

¹¹ *A Brief History of Credit Unions*, NAT'L CREDIT UNION ADMIN., <http://www.ncua.gov/about/history/Pages/CUHistory.aspx> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/P25Y-52QD>.

¹² *Id.* (“The popularity of credit unions grew because commercial banks and savings institutions generally showed limited interest in offering such consumer loans.”).

differentiated themselves from other financial institutions through their not-for-profit, democratically-run, and member-owned structure.¹³ Credit unions are also different in that they are not open to the general public,¹⁴ only serving those within their field of membership.¹⁵ Twenty-five years after the first United States credit union, St. Mary's Cooperative Credit Association,¹⁶ opened its doors, Congress passed the Federal Credit Union Act (FCUA).¹⁷ The FCUA established federal laws regulating the process of chartering and supervising federal credit unions.¹⁸ The National Credit Union Administration (NCUA), the federal governing agency for credit unions, states that the FCUA serves the purpose of creating available credit and promoting thrift "through a national system of nonprofit, cooperative credit unions."¹⁹ Further, the NCUA describes credit unions as "member-owned, not-for-profit, cooperative financial institution(s)."²⁰

The primary purpose of credit unions was then, and continues to be, consumer lending.²¹ However, member business lending—commercial lending—has always been a service offered by credit unions.²² Part B of this Section further discusses the statutory definition of a credit union member business loan that appears in the Credit Union Membership Access Act (CUMAA) and notes the additional statutory exceptions and provisions.²³ For present purposes, it is enough to know that CUMAA defines a member business loan as "any loan, line of credit, or letter of credit, the proceeds

¹³ *The Credit Union Difference*, CREDIT UNION NAT'L ASSOC., <http://www.cuna.org/Thecredituniondifference/> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/HK39-2PBE>.

¹⁴ *Id.*

¹⁵ *Id.* ("People qualify for a credit union membership through their employer, organizational affiliations like churches or social groups, or a community-chartered credit union.")

¹⁶ *A Brief History of Credit Unions*, *supra* note 11. St. Mary's Cooperative Credit Association was opened by a group of Franco-American-Catholics, with the help of Alphonse Desjardins, in Manchester, New Hampshire. *Id.* Desjardins also organized the first credit union in North America, La Caisse Populaire de Levis, in Levis, Quebec in 1900. *Id.* "A court reporter, Desjardins became aware of loan sharks charging outrageous interest. In response, he organized this first credit union in North America to provide affordable credit to working class families." *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *History*, NAT'L CREDIT UNION ADMIN., <http://www.ncua.gov/about/History/Pages/History.aspx> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/49KZ-XFLH>.

²⁰ *Press Kits*, NAT'L CREDIT UNION ADMIN., <http://www.ncua.gov/News/PressKits/Pages/default.aspx> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/PL3G-ZAQ2>.

²¹ *History*, *supra* note 19.

²² CUNA, *supra* note 6, at 1 ("Although the majority of credit union lending has always been in loans to consumers, credit unions have engaged in business lending since their inception in the US in 1908.")

²³ *See infra* Part I.B.

of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose”²⁴ A member business loan is essentially credit that is provided to a member of the credit union for some corporate or business purpose.²⁵

Much of the argument for a member business lending cap came and continues to come from banking interests and some members of Congress who are concerned that credit unions do not have the expertise to engage in significant commercial lending.²⁶ Those concerned worry that if credit unions do not have the expertise to handle commercial lending, and member institutions fail in large enough quantities, the safety and soundness of not only individual credit unions but also of the NCUA-operated NCUSIF could be placed at risk.²⁷ Banking interests argue that if the NCUSIF were to fail, taxpayer dollars would be needed to recapitalize failed credit unions.²⁸ However, it is important to note that the NCUSIF is funded by credit unions and has never received federal tax dollars.²⁹ This Note will further rebut the safety and soundness concerns in Parts III, IV, and V.³⁰

The 1980s brought about a need for increased supervision and regulation of credit unions from NCUA.³¹ “In the 1980s and early 1990s, member business lending was a factor in a number of credit union failures, and it contributed to losses to the Share Insurance Fund.”³² The NCUA established member business lending regulations in 1987 to combat safety and soundness concerns.³³ These regulations were further strengthened in 1991.³⁴ A 2001 U.S. Department of the Treasury study (“2001 Treasury study”), ordered as part of CUMAA, noted that after the NCUA amended its member

²⁴ Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, § 203, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)).

²⁵ *Id.*

²⁶ See generally *Legislative History of Credit Union Member Business Lending Cap*, INDEP. COMTY. BANKERS OF AM. [hereinafter ICBA], archived at <http://perma.cc/DLD2-TD8L>.

²⁷ *Press Kits*, *supra* note 20 (“The NCUSIF insures individual accounts up to \$250,000 and joint accounts up to \$250,000 per member.” The NCUSIF “insures the deposits of credit union members and functions like the FDIC’s Deposit Insurance Fund for banks.”).

²⁸ See generally ICBA, *supra* note 26.

²⁹ National Credit Union Administration, *Share Insurance Fund—Overview*, NCUA.GOV, <http://www.ncua.gov/about/SIF/Pages/default.aspx> (last visited Mar. 26, 2015), archived at <http://perma.cc/4P6F-QGCU> (“Credit unions voluntarily capitalized the Fund in 1985 No federal tax dollars have ever been placed in the credit union financial Fund.”).

³⁰ See *infra* Parts III, IV, and V.

³¹ U.S. Dep’t of the Treasury, *Credit Union Member Business Lending*, at 7 (2001) [hereinafter 2001 Treasury Study], available at <http://perma.cc/9UVA-25AJ>.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

business lending regulations in 1991 and the economy improved, “the quality of credit unions’ member business lending portfolios grew stronger through the 1990s.”³⁵ Member business lending delinquencies improved from 8.2 percent in 1993 to 1.84 percent in 2000.³⁶ This improvement occurred before the end of the three-year deadline CUMAA imposed for credit union compliance with the cap.³⁷ Clearly, the NCUA regulations were effective in addressing safety and soundness concerns related to credit union member business lending.³⁸ Further, the Treasury Department concluded that member business lending on its own does not “pose material risk to the Share Insurance fund.”³⁹

Finally, the 2001 Treasury study also delved into the key differences between commercial lending at credit unions and banks.⁴⁰ The Treasury came up with four distinguishing characteristics of credit unions.⁴¹ Part III.B provides further discussion on how the first three characteristics, among other factors, discourage the risky commercial lending practices that other financial institutions often face.⁴² First, credit unions have limited fields of membership and thus are more restricted with regard to whom they may lend than are banks.⁴³ Second, credit union loans “generally require the personal guarantee of the borrower”⁴⁴ This means that credit unions’ member business loans are generally required to force the debtor to personally guarantee the loan and accept personal liability for it.⁴⁵ National banks have no such requirement.⁴⁶ Third, credit union commercial loans “generally must be fully collateralized”⁴⁷ This means that the loans are generally fully secured by the debtor’s collateral. Collateralized loans are less risky for credit unions than the uncollateralized loans that banks can often provide.⁴⁸

³⁵ *Id.* at 11.

³⁶ *Id.*

³⁷ Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)), § 203.

³⁸ 2001 Treasury Study, *supra* note 31, at 11.

³⁹ *Id.* at 38 (“If every credit union member business loan outstanding as of December 31, 1999, defaulted at a total loss ... and the credit unions suffered no other losses, the Share Insurance fund would have remained solvent by \$3.1 billion.”).

⁴⁰ *Id.* at 4.

⁴¹ *Id.*

⁴² *See infra* Part III.B.

⁴³ 2001 Treasury Study, *supra* note 31, at 4.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *See* Justin Pritchard, *Collateral Loans—What You Need to Know About Collateral Loans*, ABOUT.COM, <http://banking.about.com/od/businessbanking/a/collateralloans.htm> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/554K-P4D4> (“By using a collateral loan, the lender takes less risk, and it may be easier for you to get funding.”).

Fourth, credit unions are limited by the 12.25 percent cap, while banks have no asset cap on commercial lending.⁴⁹ A cap, regardless of whether it is at 12.25 percent or a higher number, prevents credit unions from engaging in the quantity of the more profitable—but sometimes riskier—commercial lending that banks engage in.

In addition, because credit unions are not-for-profit, there is less incentive for risky lending than in for-profit financial institutions.⁵⁰ Because credit unions do not have outside shareholders and do not have to pay dividends to demanding outside shareholders, but rather reinvest profits back into the credit union itself, there is not the same pressure and incentive to make high-risk, high-reward commercial loans that impact safety and soundness.⁵¹

A. The Catalyst for Change: National Credit Union Administration v. First National Bank & Trust Co.

In *National Credit Union Administration v. First National Bank & Trust Co.* (*First National Bank*), the United States Supreme Court dealt a devastating blow to the credit union industry.⁵² Congress quickly passed CUMAA to counteract the holding in *First National Bank* and allow credit unions to again have multiple common bonds among their fields of members.⁵³ However, this return to multiple common bonds came at a cost. The cost came in the form of substantial new regulation on credit unions and the imposition of the statutory 12.25 percent member business lending cap, the first of its kind.⁵⁴

The Supreme Court considered the proper interpretation of section 109 of the FCUA in *First National Bank*.⁵⁵ Since 1982, NCUA had interpreted

⁴⁹ 2001 Treasury Study, *supra* note 31, at 4.

⁵⁰ See *infra* Part III.B.

⁵¹ Lawrence Summers, *Comparing Credit Unions with Other Depository Institutions*, U.S. DEP'T. OF THE TREASURY 1, 7 (2001), available at <http://www.treasury.gov/press-center/press-releases/Pages/report3070.aspx>, archived at <http://perma.cc/UV2P-FGDQ>; Jim Wang, *Why You Need a Credit Union Account*, U.S. NEWS, <http://money.usnews.com/money/blogs/my-money/2011/04/26/why-you-need-a-credit-union-account> (last visited Mar. 26, 2015), archived at <http://perma.cc/95Z7-QZFS>.

⁵² See generally *Nat'l Credit Union Admin. v. First Nat'l Bank & Trust Co.*, 522 U.S. 479 (1998). The 1998 decision resulted in swift legislative action from Congress in the form of CUMAA. See *infra* Part I.B.

⁵³ Staff Writer, *A Lasting Legacy: H.R. 1151 Remembered on 10th Anniversary*, CREDIT UNION TIMES (Mar. 5, 2008) [hereinafter *H.R. 1151 Remembered*], <http://www.cutimes.com/2008/03/05/a-lasting-legacy-hr-1151-remembered-on-10th-anniversary>, archived at <http://perma.cc/8BJY-LPKF>.

⁵⁴ See generally Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)).

⁵⁵ *First National Bank*, 522 U.S. at 479 (Section 109 states that “[f]ederal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district.”).

section 109 “to permit federal credit unions to be composed of multiple, unrelated employer groups, each having its own distinct common bond of occupation.”⁵⁶ However, a banking coalition made up of five commercial banks and the American Bankers Association took exception to the multiple common bond interpretation and filed suit.⁵⁷ They argued that the NCUA interpretation was incorrect and contrary to section 109 of the FCUA.⁵⁸ They also argued that section 109 unambiguously required that the same occupational common bond unite all members of an occupationally defined federal credit union.⁵⁹

The Supreme Court held that the “common bond provision of [the] Federal Credit Union Act (FCUA) unambiguously required that all members of occupational credit union share a single common bond.”⁶⁰ This drastically limited the field of membership that credit unions could draw from and ran counter to the NCUA interpretation that thousands of credit unions had relied on since 1982.⁶¹ Credit unions faced substantial new limits on who they could serve.⁶² The limits created fear that many credit unions would have tremendous difficulty growing their membership base and would be presented with very serious threats to their long-term viability, and also that they would, in fact, lose a significant number of members.⁶³ Congress dealt with the potentially devastating and dramatic impact this holding had on credit unions by passing CUMAA that same year.⁶⁴

B. A Big Solution and a Big Problem: The Credit Union Membership Access Act of 1998 (H.R. 1151)

CUMAA was a legislative response to the holding in *First National Bank* and a compromise that appeased both banking and credit union

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.* (It also held that “[the] interest possessed by competing financial institutions, in limiting markets that federal credit unions could serve, was arguably within ‘zone of interests’ to be protected by provision of the Federal Credit Union Act (FCUA) limiting federal credit union membership to members of definable groups, such that these competing financial institutions had prudential standing under the Administrative Procedure Act (APA) ...”).

⁶¹ *Id.* at 519 n.3.

⁶² *H.R. 1151 Remembered*, *supra* note 53, at 1.

⁶³ *Id.* at 2 (“The effort to enact H.R. 1151 was undertaken in an environment of “life or death” for credit unions. Had we not pushed as hard as we did for this legislation, potentially millions of credit union members could have been thrown out of their credit unions—and millions more denied credit union service at all. The impact on credit unions would have been—as the bankers termed it—Hiroshima,” said Dan Mica, president/CEO of CUNA.”).

⁶⁴ *Id.* at 3.

interests.⁶⁵ It gave credit unions multi-bond fields of membership at the expense of additional regulation and the new 12.25 percent cap on member business lending.⁶⁶ CUMAA enjoyed overwhelming congressional support and an urgency to rectify the damage done by the Supreme Court's holding.⁶⁷ The House of Representatives passed the bill with a 411 to 8 vote and the Senate passed it with a 92 to 6 vote.⁶⁸ CUMAA was introduced in the House of Representatives in March of 1997 and became law in August of 1998, a mere six months after the Supreme Court's holding in *First National Bank*.⁶⁹

Title II, section 203 of CUMAA instituted the member business lending cap.⁷⁰ It "impose[d] a new aggregate limit on a credit union's outstanding member business loans of the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets."⁷¹ According to NCUA, "net worth is all of [a credit union's] retained earnings."⁷² The Act defines a member business loan as meaning "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" and does not include certain types of exempted extensions of credit, and credit:

- (i) that is fully secured by a lien on a 1- to 4-family dwelling that is the primary residence of a member;
- (ii) that is fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;

⁶⁵ *Id.* at 1, 3.

⁶⁶ 1 MICHAEL P. MALLOY, *BANKING LAW AND REGULATION* § 2, 4–85 (2d ed. 2013) ("The CUMAA also embodies some policy trade-offs; in addition to reestablishing the NCUA multiple common-bond credit union policy, the act also imposes some significant regulatory requirements on the credit union industry.").

⁶⁷ *See, e.g.*, 105 Cong. Rec. H1874 (daily ed. April 1, 1998) (statement of Rep. Bruce Vento) ("Mr. Speaker, we need to pass this bill today so that this corrective legislation with regards to credit unions will move forward expeditiously in the Senate and make its way to the President as soon as possible. Credit unions have been faced by the same competitive pressures, changing technology, and the evolution in products and services that other financial institutions are facing I urge my Colleagues to support H.R. 1151, the Credit Union Membership Access Act.").

⁶⁸ For all actions with respect to H.R.1151, including floor amendments, see Credit Union Membership Access Act, H.R. 1151, CONGRESS.GOV, <http://beta.congress.gov/bill/105th-congress/house-bill/1151/all-actions-with-amendments> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/4RTL-EPTP>.

⁶⁹ *Id.*

⁷⁰ Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)).

⁷¹ Memorandum from the Nat'l Credit Union Admin. to the Bd. of Dirs. and Mgmt. of the Federally Insured Credit Union, at 2–3 (Aug. 7, 1998) [hereinafter Memorandum], *available at* <http://perma.cc/QE22-6JL5>.

⁷² *Id.* at 3 ("Retained earnings normally includes undivided earnings, regular reserves and any other reserves.").

- (iii) that is described in subparagraph (A), if it was made to a borrower or an associated member that has a total of all such extensions of credit in an amount equal to less than \$50,000;
- (iv) the repayment of which is fully insured or fully guaranteed by, or where there is an advance commitment to purchase in full by, any agency of the Federal Government or of a State, or any political subdivision thereof; or
- (v) that is granted by a corporate credit union (as that term is defined by the Board) to another credit union.⁷³

Finally, the Act provides three ways that a credit union may be exempted from the aggregate limit.⁷⁴ Credit unions with “a limited income designation or participat[ion] in the Community Development Financial Institutions program;” “a history of primarily making member business loans;” and those “chartered for the purpose of ... primarily making member business loans” may be exempted from the limit.⁷⁵

II. THE CREDIT UNION PURPOSE: WHY THERE WAS NEVER A LEGITIMATE STATUTORY REASON FOR A 12.25 PERCENT MEMBER BUSINESS LENDING CAP

Credit unions have engaged in business lending since their inception in the early 1900s.⁷⁶ Until CUMAA was passed in 1998, no member business lending cap existed.⁷⁷ CUMAA statutorily reaffirmed that credit unions were established to serve the “credit needs of individuals of modest means.”⁷⁸ It also found that credit unions “have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.”⁷⁹ The fact that credit unions have the statutory purpose of serving such credit needs is not inconsistent with credit unions providing member business loans.⁸⁰

The specified mission of credit unions, statutorily reinforced in CUMAA, dictates that credit unions engage in serving individuals of lesser means

⁷³ Credit Union Membership Access Act (CUMAA), Pub. L. No. 105-219, § 203, 112 Stat. 913 (codified at 12 U.S.C. § 1757a (1998)).

⁷⁴ Memorandum, *supra* note 71, at 3.

⁷⁵ *Id.*

⁷⁶ CUNA, *supra* note 6, at 1.

⁷⁷ *Id.*

⁷⁸ Credit Union Membership Access Act (CUMAA), § 203(A).

⁷⁹ *Id.*

⁸⁰ Letter from Bill Cheney, President and CEO, CUNA, to Ed Royce and Carolyn McCarthy, House of Representatives, 3–4 (Feb. 14, 2013) [hereinafter Letter from Bill Cheney], available at <http://www.cuna.org/Legislative-And-Regulatory-Advocacy/Legislative-Advocacy/Letters-to-Congress/2013/2013-CUNA-Letters-to-Congress/>, archived at <http://perma.cc/7UW6-3UGH>.

and fulfill their consumer credit needs.⁸¹ It does not dictate that a strict and arbitrary limit be placed on credit unions' ability to fulfill the credit needs of member businesses,⁸² particularly of those businesses run by members of lesser means.

Lending to small businesses is a role credit unions can and do fill, and is a role not well filled by other financial institutions.⁸³ Many of these small businesses seeking credit are run by individuals of modest means.⁸⁴ In 2011 testimony before the Senate Committee on Banking, Housing, and Urban Affairs, NCUA Chairman Debbie Matz stated that “[c]redit unions serve an important niche, typically making the smallest of the small business loans.”⁸⁵ Matz provided supporting data that showed that the average credit union member business loan is \$223,000 with a median of \$127,000, while “[t]he average loan size of all commercial and industrial loans made by commercial banks is \$643,000.”⁸⁶ Further, Matz presented data that “[s]maller financial institutions play a critical role in providing credit to small businesses.”⁸⁷ All of this evidences the crucial role that credit unions fill in lending to small businesses, including those run by individuals of modest means.

Simultaneously, credit unions have continued to meaningfully serve the general credit needs of individuals of lesser means.⁸⁸ A Credit Union National Association report examined Home Mortgage Disclosure Act data from 2005 onward and stated that credit unions approved an average 12 percent more loan applications than other lenders, 67 percent compared to 55 percent, from low and moderate income individuals.⁸⁹ The same report noted that credit unions averaged 26 percent of loan originations to low and moderate income individuals, while other lenders averaged 24 percent.⁹⁰

⁸¹ Credit Union Membership Access Act (CUMAA), Title IV.

⁸² See Letter from Bill Cheney, *supra* note 80, at 3; see generally Credit Union Membership Access Act (CUMAA).

⁸³ See generally James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, HAAS SCH. OF BUS. U.C. BERKELEY, SMALL BUS. ADMIN. OFFICE OF ADVOCACY, available at <http://perma.cc/84QB-QPDA>.

⁸⁴ CUNA, *supra* note 6, at 15.

⁸⁵ *Credit Unions: Member Business Lending: Hearing Before the S. Comm. On Banking, Hous., & Urban Affairs*, 112th Cong. 6 (2011) (statement of Debbie Matz, Chairman of National Credit Union Administration) [hereinafter Matz], available at <http://perma.cc/8632-XGK3>.

⁸⁶ *Id.* at 6 and accompanying notes.

⁸⁷ *Id.* (“Commercial banks with less than \$10 billion in assets account for only 19 percent of assets, but 45 percent of small business commercial & industrial lending (using the FDIC definition). All but three credit unions have less than \$10 billion in assets.”).

⁸⁸ CUNA, *supra* note 6, at 15.

⁸⁹ *Id.*

⁹⁰ *Id.*

Credit union member business lending not only does not prevent credit unions from serving those of low or moderate income as is required, but in fact helps to further the credit union purpose of providing credit to individuals of lesser means.⁹¹ Member business lending is not inconsistent with credit unions' specified mission, but instead can help complement credit union consumer lending.⁹² The statutory credit union focus on the consumer credit needs of modest means individuals does not necessitate a member business lending cap set at 12.25 percent.⁹³ Policy considerations should determine whether a member business lending cap is necessary, and, if so, the appropriate level.⁹⁴

III. JUSTIFYING CUMAA MEMBER BUSINESS LENDING CAP: THE INACCURATE AND OVERSTATED INITIAL POLICY JUSTIFICATIONS FOR A CREDIT UNION MEMBER BUSINESS LENDING CAP

Congressional reasoning and justification for the 12.25 percent cap focused on safety and soundness concerns.⁹⁵ The pervasive justification in Congress was that credit unions were not substantially involved in business lending and should instead remain focused on consumer lending, especially to those of modest means.⁹⁶ Many lawmakers and commenters also reached the conclusion that commercial lending was outside of the statutory purpose of credit unions and an infringement upon bank lending.⁹⁷

A. Unwarranted Credit Union and NCUSIF Safety and Soundness Concerns

At the CUMAA's passage much was made over safety and soundness, likely influenced by the member business lending struggles and resulting failures of some credit unions in the 1980s.⁹⁸ However, not enough consideration was given to how truly different credit union member business loans are from commercial bank loans, nor to the very effective NCUA member business lending regulation that followed in the early 1990s.⁹⁹

⁹¹ See Letter from Bill Cheney, *supra* note 80, at 1, 3.

⁹² *Id.* at 1; CUNA, *supra* note 6, at 15.

⁹³ Letter from Bill Cheney, *supra* note 80, at 1, 3.

⁹⁴ See Parts III and IV and accompanying text for discussion of past and present policy justifications for a member business lending cap.

⁹⁵ ICBA, *supra* note 26, at 1.

⁹⁶ See *supra* Parts III and IV.

⁹⁷ *Id.* See Part IV, and this Note generally for discussion of why these concerns were likely exaggerated during CUMAA's passage.

⁹⁸ ICBA, *supra* note 26, at 1, 4.

⁹⁹ 105 Cong. Rec. S9007 (daily ed. July 27, 1998) (statement of Sen. Sarbanes) (quoting letter from Sen. Rubin), available at <http://perma.cc/VU8Z-3DEJ>.

Additionally, Congress did not place enough weight on the strength of the credit union-funded NCUSIF.¹⁰⁰ The 2001 Treasury study on credit union member business lending strongly supports the idea that the safety and soundness concerns, at least as related to member business lending, were greatly exaggerated.¹⁰¹

The NCUA issued new and strengthened member business lending regulations in 1987 and 1991.¹⁰² The NCUA issued the regulations as a response to a number of member business-related credit union failures that occurred in the late 1980s and early 1990s.¹⁰³ These failures contributed to NCUSIF losses.¹⁰⁴ In 1991, member business lending delinquencies stood at 8.2 percent.¹⁰⁵ With help from the improved, stronger NCUA regulation, the delinquencies fell to 1.84 percent in 2000.¹⁰⁶ A 2001 Treasury study, required under CUMAA, found that “member business lending alone does not pose material risk to the Share Insurance Fund.”¹⁰⁷

The Clinton Administration further supported the idea that safety and soundness concerns were tremendously overblown by Congress.¹⁰⁸ In its Statement of Administration Policy shortly before signing CUMAA into law, the Administration stated that:

[T]he Administration sees no safety and soundness basis for an amendment that would limit the ability of credit unions to make business loans to their members. Existing safeguards, coupled with the new capital and other reforms in the bill, are sufficient to protect against any safety and soundness risk from member business lending.¹⁰⁹

Clearly, the Administration felt that, as the data indicated, the NCUA regulation had done enough to pacify member business lending-related safety and soundness concerns.¹¹⁰

B. Key Differences Between Commercial Lending at Banks and Credit Unions

Congress also should have examined how the substantially different characteristics of credit union member business loans make them generally less

¹⁰⁰ 105 Cong. Rec. S9007 (daily ed. July 27, 1998) (statement of Sen. D’Amato) (introducing letter from Sen. Rubin into the record), *available at* <http://perma.cc/N3RP-JMT6>.

¹⁰¹ *See generally* 2001 Treasury Study, *supra* note 31.

¹⁰² *Id.* at 7.

¹⁰³ *Id.* at 11.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 38.

¹⁰⁸ Clinton, *supra* note 10.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

risky than much of banks' commercial lending. The not-for-profit structure of credit unions alone limits the incentive for risky commercial lending.¹¹¹ The 2001 Treasury study identified four key differences between credit union member business lending and bank commercial lending: "[T]he loans can only be made to credit union members; the loans generally require the personal guarantee of the borrower; the loans generally must be fully collateralized; and total member business lending is generally subject to a portfolio limitation of 12.25 percent of total assets."¹¹² These factors reduce the risk of harm from business loan originations of credit unions.¹¹³

The first three factors alone ensure that credit union member business loans are more limited in risk.¹¹⁴ The limited fields of membership that credit unions can serve prevent credit unions from engaging in the broad commercial lending that banks engage in.¹¹⁵ The personal guarantee that credit unions generally require makes the member acquiring the loan personally liable for it.¹¹⁶ By requiring such a guarantee, credit unions not only weed out many individuals taking substantial and unnecessary risks in acquiring the loan, but also allow for easier means of recovery should default occur. Finally, by generally requiring that credit union member business loans be fully collateralized, credit unions ensure that at the very least, some asset is backing up the loan, should default occur.¹¹⁷ All of these factors minimize the risk of credit union member business loans.

Credit unions' cooperative not-for-profit structure provides them with substantially different incentives than those of banks.¹¹⁸ As a result of their cooperative structure, credit unions do not have outside shareholders, their members own the credit union, and, unlike banks, credit unions do not pay dividends to outside shareholders.¹¹⁹ Because income from member business loans are reinvested into the credit union itself and its members, and because of the much more auxiliary role that business lending plays at credit unions,

¹¹¹ CUNA, *supra* note 6, at 2; Wang, *supra* note 51.

¹¹² 2001 Treasury Study, *supra* note 31, at 4.

¹¹³ *See generally id.*

¹¹⁴ *Id.*

¹¹⁵ Summers, *supra* note 51, at 20.

¹¹⁶ *Should You Personally Guarantee a Loan to Your Small Business?*, ALLBUSINESS.COM, <http://www.allbusiness.com/business-finance/business-loans/3528-1.html> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/N2KX-B3F6>.

¹¹⁷ *Collateralization*, INVESTOPEDIA, <http://www.investopedia.com/terms/c/collateralization.asp> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/XW6K-XPSR> (defining collateralization).

¹¹⁸ CUNA, *supra* note 6, at 2.

¹¹⁹ *Decision Point: Banks Versus Credit Unions*, FOX BUSINESS (Mar. 9, 2012), <http://www.foxbusiness.com/personal-finance/2012/03/08/decision-point-banks-versus-creditunions/>, *archived at* <http://perma.cc/7XUF-X699>.

there is considerably less pressure to engage in high-risk commercial lending.¹²⁰ When combined with the factors given by the Treasury and even a greatly elevated member business lending cap, it becomes apparent that Congress should not have been as concerned as they were about the risks associated with credit union member business lending.

IV. THE POST-2008 LENDING ENVIRONMENT: CURRENT ECONOMIC AND POLICY JUSTIFICATIONS FOR AN INCREASED CREDIT UNION MEMBER BUSINESS LENDING CAP

The financial crisis of 2008 brought tremendous changes not only to the financial and lending landscape of the United States, but also to the regulatory environment.¹²¹ The fallout from the crisis resulted in a much greater emphasis on safe lending practices for all lenders.¹²² Dodd-Frank and the creation of the Consumer Financial Protection Bureau have resulted in vast amounts of regulation designed to protect consumer borrowing, and have also influenced business lending.¹²³ Traditionally, depressed economic environments like the one post-2008 have recovered largely through an emphasis on small business job creation and improvement through more readily available capital in the form of business loans.¹²⁴ However, this has not been the case post-2008.¹²⁵ President Obama's 2013 budget plan focused on "supporting small businesses and creating jobs."¹²⁶ It is important to note

¹²⁰ CUNA, *supra* note 6, at 1, 2.

¹²¹ Koba, *supra* note 1.

¹²² *Id.*

¹²³ Joel Seligman, *Key Implications of the Dodd-Frank Act For Independent Regulatory Agencies*, 89 WASH. U. L. REV. 1, 18–20 (2011).

¹²⁴ See generally Heesun Wee, *After the Recession: A Tale of Two Americas*, NBC NEWS (Jan. 6, 2014, 11:31 AM), <http://www.nbcnews.com/business/after-recession-tale-two-americas-2D11863527>, archived at <http://perma.cc/FN57-SLUR> ("Job creation among smaller employers traditionally has jump-started recoveries. But this time, the trend has remained largely absent."); Lynda Bekore, *No Economic Recovery Without Small Business Recovery*, THE HUFFINGTON POST (June 17, 2013, 1:51 PM), http://www.huffingtonpost.com/lynda-bekore/no-economic-recovery-with_b_3451681.html, archived at <http://perma.cc/EB99-JRSF>; Major L. Clark, III & Radwan N. Saade, *The Role of Small Business in Economic Development of the United States: From the End of the Korean War (1953) to the Present*, (Office of Advocacy, U.S. Small Bus. Admin. Working Paper 2010), available at <http://www.sba.gov/advocacy/7540/12143>, archived at <http://perma.cc/NRB6-NHAS>; Joel Kotkin, *Wall Street's Hollow Boom: With Small Business and Startups Lagging, Job Recovery Unlikely*, FORBES (Mar. 13, 2013, 2:43 PM), <http://www.forbes.com/sites/joelkotkin/2013/03/13/wall-streets-hollow-boom-with-small-business-and-startups-lagging-employment-wont-pick-up/>, archived at <http://perma.cc/5LHS-D4U9>.

¹²⁵ Wee, *supra* note 124.

¹²⁶ See *Supporting Small Business and Creating Jobs*, *supra* note 3; see also J.D. Harrison, *Obama Lauds Small Business Owners in his State of the Union—But not All of Them*

that the budget emphasizes the creation of jobs “by enhancing small business access to credit.”¹²⁷ Credit unions are perfectly positioned to help provide this capital, while at the same time serving those of lesser means.

A. The Great Recession Has Resulted in Decreased Commercial Lending by Banks

Post-2008 bank commercial lending has actually decreased while credit union commercial lending has increased.¹²⁸ A 2011 Small Business Administration (SBA) paper concluded that banks “reduced their ability and willingness to make business loans, large or small.”¹²⁹ Further, the SBA found that credit union small business lending actually offsets “fluctuations in bank supplies of business loans” and “can help small business and reduce the cyclicity of their local economies.”¹³⁰ This not only evidences that credit unions have made up for the decrease in bank business loans post-2008, but that credit unions have the ability to make up for regressive bank business lending periods generally.

The trend of decreased business lending by banks and the current cap on credit union lending are particularly distressing because of the importance of credit to small businesses.¹³¹ This is disturbing not only because of the role that the lack of available credit played in causing the financial crisis, but also because of the fact that small businesses are responsible for huge numbers of jobs.¹³²

The decline in bank lending comes despite the government’s Troubled Asset Relief Program, which provided over \$400 billion to banks with the intent to restore credit.¹³³ Additionally, \$30 billion was provided from the Small Business Lending Fund.¹³⁴ The Small Business Lending Fund was

Buy It, WASH. POST (Jan. 29, 2014), http://www.washingtonpost.com/business/on-small-business/obama-lauds-small-business-owners-in-his-state-of-the-union--but-not-all-of-them-buy-it/2014/01/29/f724b462-885a-11e3-916e-e01534b1e132_story.html, archived at <http://perma.cc/4NF2-BFXX>.

¹²⁷ *Id.*

¹²⁸ See generally Wilcox, *supra* note 83.

¹²⁹ *Id.* at 27.

¹³⁰ *Id.*

¹³¹ Dan Meder, *An Early Warning System for Small Business Credit Trouble*, 23 COM. LENDING REV. 2, 9–12 (2008).

¹³² See, e.g., Debbie Keese & Alan Cameron, *SB 2231: Should Congress Expand Credit Union Lending Power?*, THE SPOKESMAN-REVIEW (May 13, 2012), <http://www.spokesman.com/stories/2012/may/13/sb-2231-should-congress-expand-credit-union/>, archived at <http://perma.cc/RSZ9-H9NM> (“Small [firms] have generated 65 percent of net new jobs over the past 17 years.”).

¹³³ *Id.*

¹³⁴ *Id.*

designed to revitalize lending to small businesses by providing smaller banks with more capital to lend.¹³⁵ Despite the fact that community banks borrowed \$4 billion from the Small Business Lending Fund in 2011, lending at community banks to small businesses actually decreased by 1.84 percent.¹³⁶ Instead, “more than one-half the money withdraw[n] from the small-business fund in 2011 [was used] to repay some of their TARP loans.”¹³⁷ The fund proved to be tremendously ineffective in accomplishing its purpose.¹³⁸

“Small-business commercial real estate and equipment finance loan volume is at its lowest level in nearly three years”¹³⁹ Given the important role that small business job creation has traditionally played in aiding economic recovery, something needs to be done to encourage greater commercial lending to small businesses.¹⁴⁰ A higher member business lending cap would encourage greater credit union small business lending and create an estimated 157,000 new jobs and add \$14 billion in loans in the first year alone.¹⁴¹

B. Credit Union Member Business Lending Largely Supplements Rather Than Replaces Bank Commercial Lending

The 2011 SBA study determined that small business loans for less than one million dollars have grown dramatically at credit unions over the last decade.¹⁴² The study showed this to be the case relative to “total loans and assets at credit unions, small business loans at community banks, and ... small business loans at all banks.”¹⁴³ In fact, the study showed that credit union member business loans actually partially offset the decline in small business lending from banks in the wake of the 2008 financial crisis.¹⁴⁴ The SBA concluded that credit union member business loans could have a substantial long-term impact because of how they tend to offset periods of

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ Emily Maltby & Angus Loten, *Tale of Two Loan Programs*, WALL ST. J. (Oct. 20, 2011, 10:41 AM), <http://online.wsj.com/news/articles/SB10001424052970204138204576603100469929700>, archived at <http://perma.cc/8UCW-2YTJ> (“‘It was basically a bail-out for 100-plus banks,’ said Giovanni Coratolo, vice president of small-business policy at the U.S. Chamber of Commerce. ‘From a point of view of a small business owner, it was very ineffective in getting funds out to small business.’”).

¹³⁹ Wee, *supra* note 124.

¹⁴⁰ Keese & Cameron, *supra* note 132.

¹⁴¹ CUNA, *supra* note 6, at 4.

¹⁴² Wilcox, *supra* note 83, at v.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

decreased small business lending from banks.¹⁴⁵ This conclusion is echoed by a Filene Research Institute study, which stated that credit unions and banks show substantially different lending patterns during recessionary periods.¹⁴⁶

The SBA study further concluded that there would be an \$0.80 net increase for every \$1 increase in the supply of credit union small business loans.¹⁴⁷ This means that only \$0.20 per \$1 of every new credit union small business loan would offset bank loans.¹⁴⁸ The SBA advised that regulators should consider this information when imposing a member business lending cap for the above reasons, and because credit unions could help create better terms and availability for loans.¹⁴⁹

In addition to largely supplementing, rather than replacing, bank loans, credit union member business loans also make up a very small part of the business lending market.¹⁵⁰ As of 2012, credit unions were responsible for 5.7 percent of the business loan marketplace.¹⁵¹ This leaves a remaining 94.3 percent of the market to banking institutions.¹⁵² Even if credit unions were eventually to double their commercial loans completely at the cost of bank loans, banks would still be left with nearly 90 percent of the commercial loan market.¹⁵³ Of course, as the SBA study showed, increased credit union business lending would mostly supplement rather than replace bank business lending.¹⁵⁴

¹⁴⁵ *Id.* (“Credit unions’ increasing share of SBLs [Small Business Loans] and the estimated offsets suggest that credit unions are increasingly important sources of SBLs as a longer-run development and in response to fluctuations in SBLs at banks.”).

¹⁴⁶ David M. Smith, *Commercial Lending During the Crisis: Credit Unions vs. Banks*, FILENE RESEARCH INST. at 11 (2012), available at <http://perma.cc/7UW6-H3ZV> (“Credit unions and banks show plainly different patterns of growth in relation to the business cycle and recessionary periods. The data show that credit unions tend to lend through recessions while banks tend to pull back.”).

¹⁴⁷ Wilcox, *supra* note 83, at vi.

¹⁴⁸ *See id.*

¹⁴⁹ *Id.* (“[R]egulators might consider the extent to which credit unions could otherwise offset fluctuations in business loans at banks when setting ceilings on business loans at credit unions. And small businesses might face better loan terms and availability if more credit unions recognized more opportunities for more SBLs.”).

¹⁵⁰ U.S. Dept. of Treas., Report on Credit Union Member Business Lending (Jan. 2001), available at <http://www.cutimes.com/2012/12/17/alabama-florida-credit-unions-report-record-member>, archived at <http://perma.cc/C75-L7HE>.

¹⁵¹ Peter Strozniak, *Alabama, Florida Credit Unions Report Record Membership Growth*, CREDIT UNION TIMES (Dec. 17, 2012), <http://www.cutimes.com/2012/12/17/Alabama-florida-credit-unions-report-record-member>, archived at <http://perma.cc/WY9X-QV2R>.

¹⁵² *See id.*

¹⁵³ *See id.*

¹⁵⁴ *See* Wilcox, *supra* note 83, at v–vi.

C. A Higher Business Lending Cap Would Encourage Safe Lending to Businesses by Credit Unions

The 12.25 percent member business lending cap discourages many credit unions from investing in developing significant commercial lending programs at their institutions.¹⁵⁵ This disincentive not only prevents numerous credit unions from providing credit to small businesses, but also can actually be counterproductive to assuaging safety and soundness concerns for individual institutions.¹⁵⁶ Put succinctly, it is just not financially worth it for most credit unions to engage in much commercial lending under the current cap.¹⁵⁷

According to NCUA Chairman Debbie Matz's testimony before the Senate Committee on Banking, Housing, and Urban Affairs, increasing the member business lending cap would actually improve credit union safety and soundness by allowing for more prudent management of lending risk.¹⁵⁸ Matz told the Committee that this is because there is generally less interest rate risk in member business lending than in long term, fixed mortgages.¹⁵⁹ By increasing the member business lending cap, credit unions could achieve greater diversification of their loan portfolios and minimize risk.¹⁶⁰

Matz also spoke about how the 12.25 percent cap deters many credit unions from engaging in member business lending at all.¹⁶¹ "With the cap, it is difficult to achieve the necessary economies of scale in terms of personnel and systems to make this type of program cost effective."¹⁶² A Credit Union National Association report stated that the current structure of the cap would result in net losses for many smaller credit unions.¹⁶³

¹⁵⁵ Michelle Samaad, *LICU Expansion, Distance From Cap Seen Blunting Need for MBL Cap Fight*, CREDIT UNION TIMES (Feb. 25, 2013), <http://www.cutimes.com/2013/02/25/licu-expansion-distance-from-cap-seen-blunting-nee>, archived at <http://perma.cc/BB9K-GNFG>.

¹⁵⁶ Clifford Rosenthal, *Credit Unions, Community Development Finance, and the Great Recession*, FED. RESERVE OF SAN FRANCISCO (Feb. 1, 2012), <http://www.frbsf.org/community-development/publications/working-papers/2012/february/credit-unions-recession/>, archived at <http://perma.cc/WW3S-LWXG>.

¹⁵⁷ CUNA, *supra* note 6, at 10–11.

¹⁵⁸ Matz, *supra* note 85, at 14 ("Although it may seem counter-intuitive, allowing credit unions to engage in more member business lending is another way in which to prudently manage risk.").

¹⁵⁹ *Id.*

¹⁶⁰ *Id.* ("An increase in the member business lending cap could allow credit unions to diversify the risk of their loan portfolio, with member business lending typically involving less interest-rate risk than long-term, fixed-rate mortgages.").

¹⁶¹ *Id.* at 11.

¹⁶² *Id.*

¹⁶³ CUNA, *supra* note 6, at 10–11 ("A \$45 million credit union is currently limited to \$5.6 million in member business loans (roughly 25 loans in total using industry loan-size

A higher cap would not only bring more capital to the market from newly established credit union lending programs, but also would likely allow for safer lending programs.¹⁶⁴ By allowing a greater level of profits from business lending, credit unions could afford to develop more sophisticated, experienced, and professional lending programs.¹⁶⁵ Providing credit unions with economies of scale would logically result in safer lending programs by allowing for greater investment in business lending programs, and employment of individuals with substantial business lending experience.¹⁶⁶ These more highly developed lending programs with more experienced employees would be made even safer by the diversification of loan portfolios that such a structure would promote.

V. CURRENT NCUA REGULATION COMBINED WITH PROVISIONS IN PROPOSED LEGISLATION ADVOCATING AN INCREASED CAP SHOULD SUCCESSFULLY ASSUAGE SAFETY AND SOUNDNESS CONCERNS

The present financial environment has seen a substantial government emphasis on creating small business growth to generate new jobs and improve the economy.¹⁶⁷ This growth requires a focus on increasing safe and available capital to small businesses. Currently proposed House and Senate legislation, discussed below, would allow this to occur.¹⁶⁸

A. *The Currently Proposed Legislation*

In 2013, members of Congress in both the House of Representatives and the Senate proposed legislation advocating an increased member business

averages). Using conservative estimates, a portfolio this size would generate approximately \$170,000 in income but would generate expenses totaling \$180,000 (approximately \$88,000 for the salary and benefits of an experienced lender, \$28,000 in loan losses and roughly \$56,000 in other operating expenses). Smaller institutions would incur larger net losses on their portfolios because many of the costs incurred are fixed.”).

¹⁶⁴ *Examining the Issue of Credit Union Member Business Lending: Hearing before the S. Comm. On Banking, Housing, and Urban Affairs*, 112th Cong. 3 (2011) (statement of Deborah Matz, Chairman of the National Credit Union).

¹⁶⁵ *Id.*

¹⁶⁶ *See also* Matz, *supra* note 85, at 11 (“Effective member business lending requires the creation of internal policies and procedures to engage safely and soundly in this activity. It also requires the hiring of professionals with sufficient knowledge of business lending to judge the quality of the loan applications and to monitor the performance of the loans once made—especially cash flow, portfolio management, and liability issues.”).

¹⁶⁷ *See* Office of Management and Budget, *Supporting Small Business and Creating Jobs*, WHITEHOUSE.GOV, <http://www.whitehouse.gov/omb/factsheet/supporting-small-businesses-and-creating-jobs> (last visited Mar. 26, 2015), *archived at* <http://perma.cc/8ABB-2AY4>.

¹⁶⁸ *See infra* Part V.B.

lending cap.¹⁶⁹ Representatives Ed Royce (R-CA) and Carolyn McCarthy (D-NY) introduced bipartisan legislation in Congress in February 2013.¹⁷⁰ H.R. 688, the “Credit Union Small Business Jobs Creation Act,” proposes substantial changes to member business lending restrictions on credit unions, with the goal of stimulating lending to small businesses and, as a result, job creation at no cost to taxpayers.¹⁷¹ In May 2013, a bipartisan group of Senators, led by Mark Udall (D-CO), introduced similar legislation in the form of S. 968, the “Small Business Lending Enhancement Act of 2013.”¹⁷²

The proposed legislation would increase the member business lending cap on credit unions from 12.25 percent of total assets to 27.5 percent of total assets.¹⁷³ However, not every credit union would be eligible for the increased cap.¹⁷⁴ The legislation provides multiple requirements that a credit union must meet to be eligible for the increased cap.¹⁷⁵ These requirements are implemented to ensure safe and sound lending practices.¹⁷⁶

To be eligible, a credit union must:

[B]e considered well capitalized [currently 7% net worth ratio]; have at least 5 years of member business lending experience; be at or above 80% of the current 12.25% cap for at least 1 year prior to applying; [and] be able to demonstrate sound underwriting and servicing based on historical performance and strong leadership management.¹⁷⁷

The combination of these provisions, and the NCUA’s assurances regarding vigorous supervision and amended rules should the cap be raised, more than sufficiently address any concerns surrounding the safety and soundness of credit union member business lending.¹⁷⁸ Additionally, the studies that the

¹⁶⁹ Heather Anderson, *Udall Introduces MBL Bill in Senate*, CREDIT UNION TIMES (May 16, 2013), <http://www.cutimes.com/2013/05/16/udall-introduces-mbl-bill-in-senate>, archived at <http://perma.cc/8BYT-F9J9>.

¹⁷⁰ H.R. 688—Credit Union Small Business Jobs Creation Act (CUSBJCA), 113th Cong. (2013).

¹⁷¹ Press Release, *U.S. Representative Ed Royce, Royce, McCarthy Introduce Credit Union Small Business Jobs Creation Act* (Feb. 14, 2013), available at <http://Royce.house.gov/news/documentsingle.aspx?DocumentID=320166>, archived at <http://perma.cc/6294-H7ZJ> (“This legislation will not only allow credit unions to lend an additional \$13 billion to small businesses, but will create 140,000 new jobs in the process,” said Royce. “With a stagnant job market and unemployment rising to 7.9 percent, the Credit Union Small Business Jobs Creation Act is an important step in getting Americans back to work.”).

¹⁷² S. 968—Small Business Lending Enhancement Act of 2013, 113th Cong. (2013).

¹⁷³ H.R. 688.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Member Business Lending*, NAT’L ASSOC. OF FED. CREDIT UNIONS, <http://www.nafcu.org/mbl/> (last visited Mar. 26, 2015), archived at <http://perma.cc/UNZ7-REUT>.

¹⁷⁸ See *infra* Part V.C.

proposed legislation requires the NCUA and the Comptroller General of the United States to undertake assure that any safety and soundness concerns are remedied quickly, and that credit unions do not stray from satisfactorily accomplishing their statutory mission regarding lending to consumers and those of lesser means.¹⁷⁹

B. The Impact of the Currently Proposed Legislation's Structure on Safety and Soundness

The proposed Senate and House legislation strongly considers and provides for safe and sound business lending practices among credit unions.¹⁸⁰ The requirements that a credit union must meet to become eligible for the increased cap ensure that credit unions have the necessary experience, knowledge, and monitoring to successfully engage in business lending on a larger scale.¹⁸¹

The structure that the proposed legislation undertakes strongly addresses safety and soundness concerns.¹⁸² The amendment to section 107(a) of the Federal Credit Union Act is structured so that a credit union must apply to the NCUA board to become eligible for the increased 27.5 percent cap.¹⁸³ In fact, paragraph 1 of the proposed amendment states that “except as provided in paragraph 2” the cap is set at the original 12.25 percent.¹⁸⁴ If the credit union has not met the enumerated criteria listed above in paragraph 2, including any additional regulations that the NCUA should establish, then the credit union will remain subject to the credit union cap that Congress statutorily imposed in 1998.¹⁸⁵ This assures that only credit unions that meet the qualifications that Congress and the NCUA deem sufficient to verify safe and sound lending practices are able to enjoy the increased cap.¹⁸⁶ The structure would prevent credit unions that do not have the necessary experience, capital structure, or track record of safe lending from engaging in more substantial business lending.¹⁸⁷

¹⁷⁹ H.R. 688—Credit Union Small Business Jobs Creation Act (CUSBJCA), § 2(c), 113th Cong. (2013).

¹⁸⁰ *Id.* § 2(a).

¹⁸¹ *Id.* § 2(a)(a)(2).

¹⁸² *Id.* § 2(a)(a)(3).

¹⁸³ *Id.* § 2(a).

¹⁸⁴ *Id.* (“(1) In general. Except as provided in paragraph (2), an insured credit union may not make any member business loan that would result in the total amount of such loans outstanding at that credit union at any one time to be equal to more than the lesser of— ... (B) 12.25 percent of the total assets of the credit union.”).

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

C. The Proposed Legislation's Requirements for Increased Member Business Lending Authority Should Allay Related Safety and Soundness Concerns

In addition to the eligibility structure of the proposed legislation, the requirements that the amendments lay out for credit unions to meet eligibility requirements substantially decrease the risk of unsafe lending and risks to credit unions, the NCUSIF, and taxpayers.¹⁸⁸ The proposed legislation would amend section 107(a) of the FCUA to require that a credit union seeking NCUA board approval for an increase to the 27.5 percent cap:

(A) [have] member business loans outstanding at the end of each of the 4 consecutive quarters immediately preceding the date of the application, in a total amount of not less than 80 percent of the applicable limitation under paragraph (1);

(B) [be] well capitalized, as defined in section 216(c)(1)(A);

(C) can demonstrate at least 5 years of experience of sound underwriting and servicing of member business loans;

(D) has the requisite policies and experience in managing member business loans; and

(E) has satisfied other standards that the Board determines are necessary to maintain the safety and soundness of the insured credit union.¹⁸⁹

A credit union must meet all of these requirements before NCUA even has the option of allowing it to lend under the increased cap.¹⁹⁰

The first requirement that the proposed legislation would impose demands that a credit union have enough in total outstanding member business loans to have at least 80 percent of the 12.25 percent cap filled for four straight quarters.¹⁹¹ This means that a credit union must have at minimum 9.8 percent of its total assets in outstanding member business loans for at least one year.¹⁹² The extended period of business lending at a level near the upper echelon of the cap provides the NCUA with—at minimum—one year of relatively substantial business lending data with which to analyze a credit union's business lending program.¹⁹³ The requirement also ensures that credit unions have experience in business lending at a level that uses a

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.* § 2(a)(2)(A).

¹⁹² *Id.* § 2(a)(a)(1).

¹⁹³ *Id.*

more considerable proportion of their total assets.¹⁹⁴ This requirement should provide credit unions with more experience in business lending and ease concerns related to potential unsafe and imprudent business lending that inexperienced credit unions might undertake with an increased cap.¹⁹⁵ The information provided to the NCUA under this requirement should also ensure that credit unions, whose lending practices could pose a risk to their institution and the NCUSIF, are not eligible for the increased cap.¹⁹⁶

The proposed legislation also requires that a credit union wishing to be subject to the elevated cap be well-capitalized.¹⁹⁷ Currently, a well-capitalized credit union must have a 7 percent net worth ratio.¹⁹⁸ “The net worth-to-asset ratio is the primary measure of each credit union’s financial strength.”¹⁹⁹ This is a higher standard than the 6 percent net worth ratio required of adequately capitalized credit unions.²⁰⁰ Well-capitalized credit unions are able to use capital to insure against “unforeseen or unusual losses.”²⁰¹ The proposed legislation again addresses safety and soundness concerns by requiring that credit unions seeking eligibility for the higher cap, and thus a higher level of outstanding business loans, are able to safely insure themselves against risk of loss. The requirement that a credit union be well-capitalized will prevent credit unions that are unable to insure adequately against business lending from engaging in higher levels of business lending.²⁰² Preventing these risky credit unions from lending beyond their means should minimize the risk of credit union failures related to business lending and subsequent losses to the NCUSIF.²⁰³

The third requirement of the proposed legislation is that the credit union be able to “demonstrate at least 5 years of experience of sound underwriting and servicing of member business loans.”²⁰⁴ This requirement forces credit unions to demonstrate healthy and safe business lending for five years before they are even able to be eligible for consideration of the increased

¹⁹⁴ *Id.* § 2(a)(2).

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* § 2(a)(2)(B).

¹⁹⁸ *Net Worth to Assets*, CUNALYZER, available at <http://www.cuanalyzer.com/FindChart.aspx?UserID=0&SnippetID=53&CDSID=9513&PeerID=10005>, archived at <http://perma.cc/RZ94-DHWC>.

¹⁹⁹ *Id.*

²⁰⁰ *Id.*

²⁰¹ *Id.*

²⁰² H.R. 688—Credit Union Small Business Jobs Creation Act (CUSBJCA), § 2(a)(a)(2)(b), 113th Cong. (2013).

²⁰³ *Id.* § 2(a).

²⁰⁴ *Id.* § 2(a)(2)(C).

lending cap.²⁰⁵ This requirement would ensure safe and sound lending practices in several ways. First, the requirement would serve a filtering function by preventing credit unions with insufficient underwriting standards and servicing from obtaining the authority to engage in greater levels of business lending.²⁰⁶ Second, it would prevent credit unions with younger and less experienced member business lending programs from engaging too rapidly in the more substantial levels of business lending that the increased cap would allow.²⁰⁷ By filtering out credit unions that do not engage in sound business lending practices and simultaneously acting as a speed bump for newer and developing business lending programs, the requirement significantly assuages concerns over potential collateral damage from increased lending authority.

The requirements set out in subsections D and E require that a credit union applying for increased business lending authority have “the requisite policies and experience in managing member business loans” and “have satisfied other standards that the [NCUA] Board determines are necessary to maintain the safety and soundness of the insured credit union.”²⁰⁸ Both of these requirements give significant authority to the NCUA in determining a credit union’s compliance and regulating what a credit union must do to be eligible for increased lending authority.²⁰⁹ The malleable nature with which these requirements can be evaluated allows the NCUA to adjust requirements to fit the economic lending environments.²¹⁰ The NCUA would have the ability to adjust the requirements to minimize risk to the safety and soundness of credit unions and the NCUSIF as is required by current conditions and evaluations.²¹¹ The flexibility allows NCUA to promulgate new regulations and standards as the health of the NCUSIF, the economy, and the business lending atmosphere require.²¹²

All of the requirements that section 2(a)(2) of the proposed legislation sets out should allay fears about the threat of inexperienced credit unions engaging in business lending in amounts greater than the original 12.25 percent cap.²¹³ Additionally, these requirements should alleviate fears concerning business lending risk, and resulting safety and soundness concerns on the

²⁰⁵ *Id.*

²⁰⁶ *Id.* § 2(a)(a)(3).

²⁰⁷ *Id.*

²⁰⁸ *Id.* § 2(a)(2)(D)–(E).

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Id.*

²¹³ *Id.*

credit union system, NCUSIF, and any need for money from taxpayers. The requirements for implementation laid out in sections 2(b) and 2(c) of the proposed legislation serve to further protect against unsafe lending and its potential impact.²¹⁴

Section 2(b)(1) provides that a “tiered approval process” be developed by NCUA that does not allow for an increase in member business lending that exceeds thirty percent per year.²¹⁵ It also requires that the approval process be “consistent with safe and sound operations.”²¹⁶ Section 2(b)(2) states that the rulemaking must ensure that the increased business lending capacity the proposed legislation would allow is only granted to “insured credit unions that are well managed and well capitalized.”²¹⁷ Finally, section 2(b)(3) states that in making rules under this subsection, the NCUA board must consider: a credit union’s experience level, “including a demonstrated history of sound member business lending”; the requirements set out in amended FCUA section 107(A)(a)(2); and any factors the NCUA Board determines “necessary or appropriate.”²¹⁸

Section 2(c) of the proposed legislation also calls for a report from NCUA to Congress within three years of the Act’s enactment and a study by the Comptroller General of the United States on member business lending by insured credit unions.²¹⁹ These studies would allow Congress to learn of any potential issues with the Act early on, and act to resolve them.²²⁰ The proposed legislation’s approval-based structure, requirements upon individual credit unions, and the balance it achieves between specified requirements the NCUA must follow and allotted flexibility to implement related standards and regulations provide an effective equilibrium.²²¹ The legislation delivers a great opportunity to increase the credit available to small businesses and spur job creation at no cost to tax payers while at the same time easing fears, whether warranted or not, about credit union and NCUSIF safety and soundness.

D. The NCUA Support for an Increased Cap and Role in Maintaining Safe and Sound Lending Member Business Lending

The NCUA, the SBA, and the Treasury have all issued support for raising or further examining the member business lending cap to allow increased

²¹⁴ *Id.* § 2(b).

²¹⁵ *Id.* § 2(b)(1).

²¹⁶ *Id.*

²¹⁷ *Id.* § 2(b)(2).

²¹⁸ *Id.* § 2(b)(3).

²¹⁹ *Id.* § 2(c).

²²⁰ *Id.* § 2(c).

²²¹ *Id.* § 2(c).

credit union member business lending. In a 2010 letter to the House Committee on Financial Services, former Secretary of the Treasury Timothy Geithner stated that the Treasury would support an increased member business lending cap “provided [potential] safety and soundness concerns are addressed.”²²² This letter was in response to the then-House Committee on Financial Services Chairman Barney Frank’s request for “the views of the Treasury Department concerning current limits on the total amount a credit union can loan in the form of business loans to credit union members.”²²³ The Treasury provided a number of recommendations and offered to work with Congress on legislative proposals to guard against potential risks “to credit union members, the credit union system, the National Credit Union Share Insurance Fund, or the financial system as a whole.”²²⁴ These recommendations were closely followed in the Credit Union Small Business Jobs Creation Act proposed in 2013.²²⁵ The proposed Act provides nearly identical requirements to those recommended by the treasury.²²⁶

NCUA Chairman Debbie Matz has repeatedly issued support for raising the member business lending cap.²²⁷ Additionally, Matz has given numerous assurances that if the cap were to be raised, NCUA would quickly amend its rules and strictly enforce the law.²²⁸ In 2010, Matz wrote to Secretary Geithner to assure him that, if the cap were statutorily raised, NCUA would be ready to revise their regulations to prevent any safety and soundness risks.²²⁹ In her 2011 testimony before the Senate Committee on Banking,

²²² Letter from Timothy Geithner, U.S. Sec’y of the Treasury, to Barney Frank, Chairman of the House Comm. on Fin. Servs. (May 25, 2010), *available at* https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&cad=rja&ved=0CC0QFjAB&url=http%3A%2F%2Fwww.cuna.org%2FLegislative-And-Regulatory-Advocacy%2FDownLoads%2Fgeithnerltrto_frank0810%2F&ei=56j7Upq_Aob2rAH3voHYAw&usq=AFQjCNHa-BrXP-Mvn8W3cL8jj-NQ7fJ1Tw&sig2=dGV3uxBN5HOPq3w78dAwwA&bvm=bv.61190604,d.aWM, *archived at* <http://perma.cc/8LTU-3PGQ>.

²²³ *Id.*

²²⁴ *Id.*

²²⁵ *Compare id.*, with *supra* note 177.

²²⁶ Both propose a structure that increases the cap for only those credit unions who meet the same five enumerated standards: be at 80 percent of the current cap for four consecutive quarters; be well capitalized; have a minimum of five years member business lending experience; have the necessary policies and experience in managing member business loans; and satisfy whatever other standards NCUA requires. H.R. 688—Credit Unions Small Business Jobs Creation Act, 113th Cong. (2013). Both also limit business loan growth for eligible credit unions at 30 percent annually and require credit unions to cease member business lending if they are less than well capitalized.

²²⁷ National Credit Union Administration, *The NCUA Report*, NCUA 2 (July 2011), *available at* <http://perma.cc/4LNE-JBX2>.

²²⁸ *Id.*

²²⁹ Letter from Debbie Matz, NCUA Chairman, to Timothy Geithner, U.S. Sec’y of the Treasury (Feb. 24, 2010), *available at* <http://perma.cc/HJK5-9JT5> (“Let me assure you: If

Housing, and Urban Affairs, Matz again reiterated the agency's commitment to doing whatever is necessary to prevent safety and soundness risk, should the cap be raised.²³⁰ In the same testimony, Matz advocated for statutorily increasing the cap.²³¹ The NCUA support for an increased cap and its readiness to amend regulations and provide strong enforcement indicate an immense commitment by the NCUA to ensure that credit unions, the NCUSIF, and the economy are not at risk due to increased member business lending authority.²³²

The SBA also suggested raising the member business lending cap.²³³ The SBA determined that credit union member business loans tend to offset declines in business lending at banks.²³⁴ It concluded that this suggests examining the cap on member business loans.²³⁵ It further resolved that small businesses might face a better lending environment if credit unions could provide more business loans.²³⁶ These determinations demonstrate support for allowing credit unions greater member business lending authority.

It is clear that numerous federal agencies have come to the conclusion that significant advantages could be gained by prudently raising the member business lending cap.²³⁷ The suggestions that the Treasury Department provided for assuring that an increased cap minimizes risk,²³⁸ the NCUA support and eagerness to amend and enforce regulation as necessary,²³⁹ and the studies of the SBA²⁴⁰ strongly suggest that a prudent increase in the member business lending cap is not only possible, but warranted.

legislative changes increase or eliminate the current aggregate MBL cap, NCUA would promptly revise our regulation to ensure that additional capacity in the credit union system would not result in unintended safety and soundness concerns.”).

²³⁰ Matz, *supra* note 85, at 21 (“NCUA is committed to remaining vigilant in carrying out its fiduciary responsibilities over the NCUSIF. Should Congress increase the MBL lending limit for credit unions, NCUA will ensure its prudential regulatory framework is further enhanced to manage the associated risks.”).

²³¹ *Id.* at 2 (“This written testimony will ... demonstrate how prudently raising the MBL cap would benefit small businesses, local communities, and the U.S. economy.”).

²³² *Id.*

²³³ See generally Wilcox, *supra* note 83.

²³⁴ *Id.* at vi.

²³⁵ *Id.* (“[R]egulators might consider the extent to which credit unions could otherwise offset fluctuations in business loans at banks when setting ceilings on business loans at credit unions.”).

²³⁶ *Id.* (“[S]mall businesses might face better loan terms and availability if more credit unions recognized more opportunities for more SBLs.”).

²³⁷ *Id.* at 2.

²³⁸ *Id.* at 20.

²³⁹ *Id.* at 8–9.

²⁴⁰ *Id.* at 7–8.

CONCLUSION

Member business lending has been a part of what credit unions do since they first appeared in the United States in 1908. Credit unions were not subject to a member business lending cap until CUMAA's passage in 1998. There was never a legitimate statutory reason for the implementation of a member business lending cap, and the initial policy justifications—namely safety and soundness concerns—for the cap were not as convincing as they were made out to be. NCUA regulations solved the member business lending problems of the late 1980s and early 1990s. Further, had the Supreme Court not forced Congress to enact the 1998 legislation that statutorily returned credit unions' ability to serve multiple common bonds of members, it is questionable whether a member business lending cap would have ever been created.

The current economic and regulatory landscape strongly encourage raising the 12.25 percent member business lending cap on credit unions. Prudently increasing credit union member business lending authority, such as would be done by the proposed Credit Union Small Business Jobs Creation Act,²⁴¹ would provide far-reaching support for small business and job growth, as is emphasized in President Obama's 2013 Budget,²⁴² at no additional cost to taxpayers. The significant number of jobs and additional capital that increased business lending authority would produce, particularly to small businesses, would provide substantial benefit to the economy as it continues to recover from the 2008 financial crisis.

²⁴¹ See generally H.R. 688—Credit Union Small Business Jobs Creation Act (CUSBJCA), 113th Cong. (2013).

²⁴² See *Supporting Small Business and Creating Jobs*, *supra* note 3.