

Helping Credit Unions
Serve Low-Income Communities:
Challenges, Strategies &
Recommendations for Foundations

FINAL REPORT

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Background

NATIONAL ECONOMIC DEVELOPMENT & LAW CENTER

The National Economic Development & Law Center (NEDLC), established in 1969, is a non-profit public interest law and planning organization that specializes in community economic development. NEDLC works in collaboration with community organizations, private foundations, corporations, and government agencies to build the human, social, and economic capacities of low-income communities and their residents. NEDLC helps to create both strong, sustainable community institutions that can act as “change-agent,” and an effective local infrastructure for their support.

ACKNOWLEDGEMENTS

This publication, *Helping Credit Unions Serve Low-Income Communities: Challenges, Strategies, and Recommendations for Foundations*, would not have been possible without the time, energy, and thoughtfulness of the twenty-eight leaders in the credit union field who were interviewed for this project.

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INTRODUCTION

Credit unions have a rich and proud history of helping low-income households gain access to credit and affordable financial services. The preamble to the Federal Credit Union Act of 1934 states that the public purpose of credit unions is to “establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit.”¹ Sixty-four years later, the Credit Union Membership Access Act of 1998 (CUMAA) reaffirmed that credit unions have “the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.”² By loosening restrictions on who is eligible to join credit unions, legislative and regulatory changes over the past two decades have made it possible for credit unions to serve more low-income households than ever before.

At the same time, with the rampant growth of the alternative financial services industry, it is clear that the financial needs of many low-income households are not adequately being met by mainstream financial service providers. According to the Federal Reserve Board’s Survey of Consumer Finances, there are approximately ten million unbanked households in the U.S. According to the U.S. Treasury Department, the number of check-cashing stores has doubled to roughly 5,600 since 1986, and the check cashing industry predicts a 600 percent growth within the next decade. There are an estimated 2,200 payday lending stores nationwide, 50% more than the number of McDonalds. Thus, the need to better connect low- and moderate- income people both to credit unions and banks is as pressing today as it ever has been in the past.

This report provides recommendations to the philanthropic community on strategies to help mainstream credit unions reach and serve more low-income households. By gaining a deeper understanding of the challenges, opportunities, motivations, and means to measure performance, the hope is that more low-income households will reap the financial benefits of belonging to a credit union.

RESEARCH METHODOLOGY

In addition to reviewing the available literature on credit unions service to low-income households, the National Economic Development and Law Center (NEDLC) conducted a series of in-depth interviews with twenty-eight leaders in the field. These stakeholders included representatives of:

- Credit unions and credit union leagues
- Industry trade associations
- Regulatory agencies
- Research institutions
- Foundations
- Consumer advocates, and
- Consultants.

¹ Federal Credit Union Act of 1934, Public Law 416

² Credit Union Membership Access Act of 1998, Public Law 105-219

The interviews lasted approximately one to two hours and covered the following four topical areas:

- Mainstream credit unions' experience in serving low-income households;
- Motivations and challenges in serving this market;
- Strategies needed to encourage more credit unions to target and serve more low-income households; and
- Recommendations on how foundations can contribute to this issue.

The report depicts the views of a broad range of stakeholders in the credit union field who have, in some cases, dramatically divergent opinions on the issues. Some leaders champion what credit unions have already done to help low-income households; others criticize that not enough effort has been made. Because this report is not a quantitative study, it does not attempt to answer the question of *whether enough* is currently being done by credit unions to serve low-income households, but rather addresses the question of *how more* could be done in the future. To be clear, some mainstream credit unions already excel in providing financial services to low-income communities. These credit union leaders in the field have branches in low-income areas, customized products and services for low-income people, and innovative partnerships with community development credit unions, public agencies, and community-based organizations. Such credit unions would likely already meet any standard of service proposed. Thus, the report aims not at criticizing what has or has not been done in the past but, rather, the purpose is to discuss strategies which may help the industry as a whole move forward in the future.

This report differs from the existing literature in that it is the only *independent* analysis which addresses the specific barriers, opportunities and resources necessary for credit unions to serve more low-income households from a wide range of perspectives. With the possible exception of research by the Woodstock Institute,³ nearly all of the existing research in the field is funded, by or through, organizations either affiliated with the industry trade associations or consumer advocacy groups.⁴

DEFINITIONS

Since neither the industry nor the enabling credit union legislation has a common working definition of *low-income* or *people of modest means*, we purposely chose in our discussions to allow the leaders in the field to interpret these terms freely. If future performance measures or standards were to be adopted, a common definition of low-income would need to be developed.

The primary focus of this report is on credit unions which have been granted a federal charter to serve all or part of a geographic area. This includes community chartered credit unions as well as credit unions which have adopted “underserved” geographic areas into their

³ The Woodstock Institute is a Chicago-based policy and advocacy nonprofit that works locally and nationally to promote community reinvestment and economic development in lower-income and minority communities. The Institute engages in applied research, policy analysis, technical assistance, public education, program design and evaluation.

⁴ During the scope of this work, NEDLC asked each of the 27 leaders in the field for recommendations on relevant literature, in addition to scanning related websites for material. It is possible that there is other independent research, but if so, it was not recommended to us.

field of membership.⁵ As of midyear 2005, there are roughly 2,500 credit unions in this category, comprising approximately 30% of all credit unions.⁶ The analysis explicitly excludes community development credit unions, whose sole mission is to serve the needs of low-income households and communities. The analysis also excludes occupational, associational or multiple-bond credit unions which have *not* amended their charter to incorporate low-income areas. NEDLC chose to concentrate this work on mainstream credit unions, as opposed to community development credit unions, because they have the capacity and resources to have a significant impact on helping low-income households access financial services and products. Lastly, while the focus is on federally-chartered credit unions, many of the strategies discussed may also apply to state-chartered credit unions, about 96% of which receive federal insurance. In general, the goal is to help, encourage, motivate, and empower all credit unions to serve all people within their respective fields of membership.

BACKGROUND IN BRIEF

Credit unions are distinct from banks in four ways. Unlike banks, credit unions are:

1. Member-owned cooperatives run by voluntary boards, elected by the membership;
2. Non-profit entities that build capital by retained earnings, not by issuing capital stock;
3. Restricted to serve specific groups of people; and
4. Tax exempt.

The federal government estimates that the tax savings is between \$1.2-\$1.6 billion dollars a year,⁷ and the exemption is justified, according to the Credit Union Membership Access Act of 1998, on the basis of credit unions' democratic structure and their specific mission of meeting the credit and savings means of people of modest means.⁸

Over the past several decades, as credit unions have expanded their charters, begun offering a wider range of services, and grown in assets, the distinction between credit unions and banks has become less clear. And just as the banking industry has consolidated and concentrated its assets, so, too, has the credit union industry. The Government Accountability Office (GAO) reports that between 1992 and 2004 the total assets held by federal credit unions more than doubled, while the total number of credit unions declined by 28%, resulting in two distinct types of credit unions. By the end of 2004, according to the GAO, "credit unions with more than \$100 million in assets represented about 13% of all credit unions and 79% of total

⁵ According to the National Credit Union Administration (NCUA) which federally regulates credit unions, an underserved area includes any of the following: an Empowerment or Enterprise Community, an area where at least 20% of the population is living in poverty; a Metropolitan Area where median family income is no more than 80% of the Metropolitan Area median income; an area outside of a Metropolitan Area where median family income is no more than 80% of the state-wide non-Metropolitan Area; an area where the unemployment rate is at least 1.5 times the national area; and an area meeting the criteria for economic distress under the Community Development Financial Institutions Fund. See the National Credit Union Administration's Chartering and Field of Membership Manual, March, 2003.

⁶ The Credit Union National Association provided statistics on the number of community-chartered credit unions. The statistic on the number of credit unions which have adapted underserved areas comes from NCUA News Release, www.ncua.gov/news/press_release/2005/NR05-0123.htm

⁷ U.S. House of Representative Committee on Ways and Means Hearing, November 3, 2005, Testimony of Richard J. Hillman, U.S. Governmental Accountability Office

⁸ See Public Law 105-219, August 7, 1998, 112 STAT. 914



assets. The consolidation in numbers and concentration of assets has resulted in two distinct groups of credit unions: a few relatively large institutions providing a wide range of services that resemble those offered by banks of the same size, and a number of smaller credit unions that provide basic financial services.”⁹

The growth of credit unions and the expansion over the years of permissible products and services have led some to question both the extent credit unions are fulfilling their historic mission of serving those of modest means as well as the justification for their tax exempt status. In fact, the continuation of credit union’s tax exemption has been the subject of a recent hearing by the U.S House Committee on Ways and Means, making the topics in this report particularly timely.

WHAT’S TO COME

1. **Section I** reviews recent regulatory and legal changes which have enabled occupationally-based credit unions to serve the larger communities in which they are located. It also discusses recent political and regulatory initiatives to help credit unions serve more low-income households and to measure their performance in doing so. Qualitatively, it is clear that some mainstream credit unions excel at meeting the financial needs of low-income households. Quantitatively, it is harder to evaluate because there is no comprehensive data on either the effort credit unions put into serving low-income households or the outcome of that effort (e.g. in terms of the number of low-income households who belong to a credit union or receive the range of credit union services.)
2. **Section II** moves us explicitly into a discussion of standards of performance measurement. What does it mean to serve “more” low-income households? How do credit unions know when they have done “enough?” On what basis should performance be measured and to what standard should they be held accountable? The discussion debates outcome- versus effort-based standards of performance and leads to the topic of data collection, outlining arguments for and against increased data collection.
3. **Section III** analyzes the many strategic, financial, and regulatory challenges involved in marketing to and serving low-income households and communities. It is only within the last several years that many mainstream credit unions have been able to serve all members of a geographic area or adopt an underserved area. Thus, the industry is going through growing pains as it learns successful techniques to market and serve lower income households within their fields of membership. Despite the initial financial costs, some leaders in the field have found doing so not only financially feasible but also profitable.
4. **Section IV** presents a wide range of strategies to help credit unions overcome these challenges, including both positive incentives and mandatory accountability mechanisms. Here we discuss field-building initiatives, financial incentives, regulatory relief, as well as regulatory and legislative enforcement policies.

⁹ U.S. House of Representative Committee on Ways and Means Hearing, November 3, 2005, Testimony of Richard J. Hillman, U.S. Governmental Accountability Office

5. **Section V** outlines arguments for and against voluntary versus mandatory mechanisms for motivating more credit unions to serve low-income households.
6. **Section VI** hones in on specific actions that foundations can take to advance its goal of greater financial services to low-income households. The report concludes with NEDLC's recommendations for the philanthropic community.



Executive Summary in Bullets

Summary of Section I Regulatory & Political Perspective

REGULATORY REVIEW

- Recent legislative and regulatory changes have enabled credit unions to expand their geographic charters & serve more low-income households
- Focus of this Report: mainstream community credit unions and credit unions with underserved areas

THE CREDIT UNIONS MISSION: LEGAL & POLITICAL PERSPECTIVE

- Credit unions were created and exempted from taxes in order to serve people of “small” or “modest” means
- There is no definition of, or standards for serving people of modest means
- In 2003, the GAO:
 - Found that credit unions serve a slightly lower percentage of low and moderate income households than banks, and
 - Called for more data and tangible indicators to measure service to people in underserved areas
- NCUA created a Modest Means Working Group & launched programs to help credit unions serve more low-income households
- NCUA tried unsuccessfully to pass regulations to document credit unions’ efforts in serving low-income households
- Credit union industry has resisted efforts to document service to low-income households and/or be subject to CRA

RECENT CONGRESSIONAL OVERSIGHT

- In November, 2005, the House Committee on Ways & Means held a hearing on “the history of the tax exemption for credit unions to determine whether credit unions are serving the goals intended with their tax exempt status”¹
- Hearing called for documentation of service to low-income households

NCUA’S RESPONSE

- On 11/30/05, NCUA expanded its Modest Means Working Group to include: “transparency, definition of modest means, and the data gathering process demonstrating service to those members.”¹
- Working Group is said to release a report within the first half of 2006
- In 2/06, NCUA begins collecting data on credit union membership and credit unions’ senior management compensation and benefits



Summary Section II

Performance Measures & Data Collection

ARGUMENTS FOR AN EFFORT APPROACH/AGAINST AN OUTCOME APPROACH

- Too Soon to Measure the Outcomes of Community Charters & Adopted Underserved Areas
- An Outcome Approach is Unnecessary & Costly
- One Size Doesn't Fit All / No Agreement on the Outcome

ARGUMENTS IN FAVOR OF OUTCOME, AGAINST AN EFFORT APPROACH

- Effort Isn't and Hasn't been Enough
- Provides Transparency & Indicators for Industry Managers
- Small Numerical Outcome Goals Can Make a Big Difference

WHICH OUTCOME- OR EFFORT-BASED STANDARD SHOULD CREDIT UNIONS ADOPT?

Examples of Outcome-based Standards

- Proportionality Standard
- Some Proportion of the Proportionality Standard
- CRA

Examples of Effort-Based Standards

- Availability of Affordable Products & Services
- Accessibility of Community Chartered Credit Unions
- Efforts to Connect to the Community

ARGUMENTS AGAINST INCREASED DATA COLLECTION

- Capacity, Cost & Burden
- Invasion of Privacy, Impediment to Joining
- First Step Toward Outcome Mandates
- Fear of What the Data Will Reveal
- No Agreement on Which Data

ARGUMENTS IN FAVOR OF INCREASED DATA COLLECTION

- Cannot Answer the Question Without the Data
- Data Collection, Itself, May Motivate Change
- Political Capital

HOW TO COLLECT THE DATA?

- Federal Mandate
- Survey Research Centers
- Private Companies
- Voluntary Industry Initiatives



Summary of Section III

Challenges in Serving Low-Income Households

STRATEGIC CONCERNS

- “Heart is there but the learning curve is huge”
- Harder to Penetrate a Community Than an Occupation or Association
- Time, Patience & Product Differentiation
- Lack of Focus Within the Industry
- Lack of Focus by Individual Credit Unions
- Perceptual Effect on Other Members

FINANCIAL CONCERNS

- Costs
- Longer Yield on Return / “Diseconomies of Scale”
- Profitable, Nonetheless!

REGULATORY CONCERNS

- Perception of Risk and Regulatory Downgrading
- NCUA Examiners Need to Lay-Off
- Restrictions on Non-Member Products & Services
- Restrictions on Interest Rates, Loans, & Types of Services



Summary of Section IV

Strategies to Help Credit Unions Overcome the Challenges

CARROT APPROACH

Address the Knowledge Gap: Build & Educate the Field on How to Serve Low-Income Populations

Address the Lack of Industry Focus

- Create an Association of Credit Unions Interested in Reaching out to Low-income households
- Publicly Promote Excellence in Service to Low-income Households
- Tie Tax Exemption to a Standard of Service

Address the Financial Concerns

- Subsidize the Costs
- Reward Good Behavior

Address the Regulatory Concerns

- Relief on Regulatory Restrictions
- Some Leniency on Regulatory Exams
- Regulatory Rewards for Excellent Service

Address the Strategic Concerns

- Publicly Promote Excellence
- Tie Tax Exemption to Excellence

STICK APPROACH

- New Regulatory Requirements for Community Credit Unions and Credit Unions With Underserved Areas
- Enact a National CRA Law for Credit Unions



Section V

Summary of the Analysis of the Strategies



ARGUMENTS IN FAVOR OF A “CARROT” APPROACH / AGAINST A “STICK” APPROACH

- Credit Unions Already Serve Low-Income Households
- What’s Needed is Help, Not Mandates
- Voluntary Action Yields Better Results
- Mandates are Politically Impossible: Better Some Change Than No Change
- New Regulatory Requirements for Credit Unions Would Prevent Them from Extending into Low-Income Markets
- CRA is not the Answer for Banks
- CRA Needs to Be Reconfigured to Work for Credit Unions

ARGUMENTS AGAINST A “CARROT” APPROACH / IN FAVOR OF A “STICK” APPROACH

- CRA has a Proven Track Record
- ‘Been There, Done That.’ Voluntary Approaches Inspired a Few But Not the Many
- Banks Only Changed When Forced
- Community Credit Unions Should Be Required to Serve All Members of the Community / Unfair Competitive Advantage



Section VI			
Report Summary: Challenges, Strategies, & Recommendations			
Challenges	Strategies		NEDLC's Recommendations to Foundations
	Carrots 	Sticks 	
Lack of Data on Effort or Outcome in Serving Low-income households	<ul style="list-style-type: none"> Convene industry leaders to discuss data collection and industry standards of service to low-income households Promote a “Good Seal” of approval program to award credit unions which meet a standard Streamline regulatory approval processes & requirements for credit unions which provide data and meet a standard Provide financial rewards to credit unions which supply data & meet the standard 	<ul style="list-style-type: none"> Federal mandate to collect data & meet a standard of service Apply CRA to credit unions now, OR Study how to adapt CRA to credit unions in the future Add a Service Test to the CAMEL safety and soundness exam Tie tax exemption to a Standard of Service 	<p><u>Developing Industry Standards: Immediate Actions</u></p> <ul style="list-style-type: none"> Convene industry leaders to discuss data collection and industry standards <p><u>Building Intermediaries: Short-Term Actions</u></p> <ul style="list-style-type: none"> Convene industry leaders to discuss the need for a new association Fund intermediary field building initiatives <p><u>Research: Short-Term Actions</u></p> <ul style="list-style-type: none"> Fund research on how to affectively adapt CRA for credit unions Fund research on the implications of lifting regulatory restrictions <p><u>Legislative & Regulatory Reforms</u></p> <p><i>Immediate Actions</i></p> <ul style="list-style-type: none"> Support current initiatives to mandate data collection and standards Support policies and trainings to provide some leniency on regulatory examinations <p><i>Short-Term Actions</i></p> <ul style="list-style-type: none"> Fund or promote policies to fund a “Good Seal” of approval program for high-performing credit unions Provide financial rewards and/or other public recognition for high-performing credit unions Fund or support policies to offset the costs of expanding service to low-income households. <p><i>Long-Term Actions: If NCUA Standards are not Mandated or Met</i></p> <p>Support strategies for the following policy reforms:</p> <ul style="list-style-type: none"> Apply an adapted CRA to credit unions Enact mandated data collection and standards Add a Service Test to the CAMEL regulatory exam Tie tax exemption to a Standard of Service
Lack of Standards on Effort or Outcome			
Lack of Knowledge, Misperceptions of Risk	<ul style="list-style-type: none"> Build & educate the Field through intermediaries 		
Lack of Industry Focus	<ul style="list-style-type: none"> Form a new association of credit unions specifically interested in serving low-income households 	<ul style="list-style-type: none"> Tie tax exemption to a standard of service 	
Regulatory Concerns	<ul style="list-style-type: none"> Provide relief on regulatory restrictions Provide leniency on regulatory exams Or research implications of these regulatory changes 		
Financial Concerns	<ul style="list-style-type: none"> Reward good behavior financially Change regulations to allow outside sources of revenue 		



Section One

REGULATORY & POLITICAL PERSPECTIVE

REGULATORY REVIEW

Credit unions are permitted only to serve people within their state- or federally-chartered field of membership. As of the end of 2004, the federal government chartered about 62% of the approximately 8,800 credit unions, and states chartered the remaining 38%, although nearly all credit unions (96%) are federally-insured.¹⁰ According to the 2003 year-end data from the Credit Union National Association—a major industry trade association—the total assets of credit unions amount to over \$629 billion and the average credit union has \$65.2 million in assets.¹¹ As noted in the Introduction, however, the industry has consolidated over the years with a small number of credit unions holding a disproportionately large share of the industry’s aggregate assets and a large number holding the remaining. In comparison to banks, credit unions are still on average smaller than banks, representing 6% of the total assets of both industries combined.¹²

Currently, there are **three types of federal credit union charters**:

1. *Single common bond*, comprised of people who share a common bond, such as employees of a particular company or governmental agency or membership in an association;
2. *Multiple common bond charters*, consisting of clusters of different groups of people, which each have a common occupational or associational bond; and
3. *Community charters*, comprising people who live, work, worship, or attend school in a specified geographical area.¹³

Over the past two decades, legislative and regulatory changes have allowed federally chartered credit unions to expand their field of membership to include larger geographic areas, add “underserved” areas, and be comprised of hundreds of common bond groups. Beginning in 1982, the National Credit Union Administration (NCUA), which regulates all federally-insured credit unions, first allowed credit unions to consist of more than one common bond, or so-called multiple bond credit unions.¹⁴ (For example, a multiple bond credit union may consist of employees in several different federal agencies, employees of a variety of health care providers, as well as several other employee groups.)

In 1998, however, the Supreme Court ruled against the National Credit Union Administration’s practice of allowing multiple bond credit unions. In response to the Supreme Court ruling, the credit union industry successfully lobbied for the passage of Credit Union

¹⁰ U.S. House of Representative Ways & Means Committee Hearing, November 3, 2005, Statement of the Honorable JoAnn Johnson, Chairman of the National Credit Union Administration

¹¹ Credit Union National Association. www.cuna.org/download/curepd03.pdf. August 3, 2004.

¹² Testimony of Richard J. Hillman, U.S. Governmental Accountability Office

¹³ National Credit Union Administration Chartering and Field of Membership Manual, NCUA 8007/M6001, March 2003

¹⁴ Government Accountability Office, Credit Unions Financial Condition has Improved but Opportunities Exist to Enhance Oversight and Share Insurance Management, October 2003

Membership Access Act of 1998 (CUMAA).¹⁵ CUMAA legislatively authorizes multiple bond credit unions and allows them to add “underserved” areas— without regard to location—to their field of membership, just as NCUA policies had previously permitted single-bond and community-chartered credit unions to do.¹⁶ An underserved area consists of a geographic area, as defined by the Community Development Banking and Financial Institutions Act of 1994, which has high rates of poverty, low-income residents or unemployment.¹⁷ Once an underserved area has been added to a credit union’s field of membership, that credit union must establish an office or facility there within two years.

Adding an underserved area to a field of membership should not be confused with a low-income credit union—commonly called a community development credit union—in which a majority of members’ household income must fall at or below 80% of the median national household income. Unlike credit unions which adopt an underserved area, low-income credit unions are eligible to accept non-member deposits and receive secondary capital and grants.¹⁸

Lastly and importantly for the purposes of this report, CUMAA specified that community-chartered federal credit unions serve a well-defined “local” area but left it at the discretion of NCUA to define what constitutes a local area. NCUA since expanded the regulatory definition of “local” community to include broader and broader geographic areas.¹⁹ In practice, NCUA has approved community charters to serve entire cities (e.g. Los Angeles, Houston,) contiguous counties (e.g. the counties of San Francisco, Alameda and Contra Costa in California; and Nassau and Suffolk County on Long Island) and even states (e.g. Washington State.)

There are a variety of reasons that single or multiple bond chartered credit unions apply to convert to a community charter or adopt an underserved area, according to credit union leaders in the field. Some credit unions seek geographical expansion because they see an unmet need in the community and are philosophically driven by the industry’s mission to serve those of modest means. Others, additionally, perceive a need to increase their membership because they may have saturated their current field of membership and/or they may want to diversify their member base because the credit union’s primary employer went out of business (e.g. military base or plant closing) or they fear it may go out of business in the

¹⁵ “Rhetoric or Reality: An Analysis of Mainstream Credit Unions’ Record of Serving Low-income households,” Jacob, Bush, Immergluck, Woodstock Institute February, 2000

¹⁶ Bill Summary & Status for the 105th Congress,
<http://thomas.loc.gov/cgi-bin/bdquery/z?d105:HR01151:@@D&smm2=m&>

¹⁷ See Footnote #4 for NCUA’s definition of an underserved area. See also the National Credit Union Administration Chartering and Field of Membership Manual, pp. 3-3, 3-4.

¹⁸ National Credit Union Administration Chartering and Field of Membership Manual, p. 3-1, 3-2

¹⁹ Effective November 2000, local community may include: 1. areas in single political jurisdictions, if the number of residents did not exceed 300,000; 2. Contiguous political jurisdictions qualified as a local community if they contained 200,000 or fewer residents (but states, noncontiguous jurisdictions and MSAs did not meet the definition of a local community; and 4) A letter describing community interaction or common interests was required or a credit union had to provide additional documentation.

As of May 2003, NCUA defined local community as any one of the following: 1. any city, county, or political equivalent in a single political jurisdiction, regardless of population size, automatically meets the definition of a local community. 2. MSAs may meet the definition of a local community provided the population does not exceed 1 million; 3. Contiguous political jurisdictions qualify as a local community if they contain 500,000 or fewer residents and 4. A letter describing community interaction or common interests is required for conditions (2) and (3) above. Otherwise, a credit union must provide additional documentation.

GAO-04-91, p. 34



future. Several leaders in the field observed that the community charters enable credit unions to tap into new markets, which is particularly important since the typical credit union customer base is aging and new membership rates have been flat or declining.

The majority of credit unions still have common or multiple bond charters. Roughly thirty percent (2,500) of all federally-insured credit unions have community charters or have added an underserved area, whereas about seventy percent (6,300) are occupationally-based without any geographic field of membership.²⁰ At the same time, community based charters are among the fastest expanding segments of the credit union industry, and increasing numbers of credit unions are adopting underserved areas.²¹ Between 2000 and 2004, for example, 697 federal credit unions adopted 1,215 underserved areas, totaling 92.1 million *potential* members, according to NCUA Chairman Johnson.²² In short, whereas credit unions were once bound to specific occupational or associational groups, many are now empowered to *potentially* serve millions more low-income households through community charters, multiple bond charters and adoption of under-served areas.

The primary focus of this report is on credit unions which have been granted a federal charter to serve all or part of a geographic area. This includes community chartered credit unions as well as other types of credit unions which have adopted underserved geographic areas into their field of membership

THE CREDIT UNION MISSION: LEGAL & POLITICAL PERSPECTIVE

While the ability to serve millions of low-income households is a relatively new phenomenon, the mission to serve people of “small means” dates back to the inception of the state credit union movement and enabling federal credit union legislation. According to the enabling legislation, the Federal Act of 1934, the purpose of federal credit unions is: “to establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit.”²³ The law, however, neither defined “people of small means,” nor prescribed any standards around service to people of small means. More recently, in 1998—nearly 65 years after the enactment of federal credit unions—CUMAA reaffirmed that the mission of credit unions is to meet the savings and credit needs of “persons of modest means.” To serve persons of modest means, moreover, is a primary reason for tax exempt status of credit unions, according to CUMAA.²⁴

While the law clearly states the mission of credit unions, it does not establish mechanisms for monitoring that the mission is met. Unlike other depository institutions, credit unions are not subject to the federal Community Reinvestment Act (CRA), which requires banks to provide a similar level of service to all of the communities from which they draw

²⁰ The total number of federally insured credit unions is taken from Statement of the Honorable JoAnn Johnson, Chairman of the National Credit Union Administration. U.S. House of Representative Ways & Means Committee Hearing, November 3, 2005. The total number of community chartered credit unions comes from CUNA (by way of an email, 12/14/05,) and the total number of adapted underserved areas comes from NCUA News Release, www.ncua.gov/news/press_release/2005/NR05-0123.htm.

²¹ U.S. House of Representative Ways & Means Committee Hearing, November 3, 2005, Statement of the Jeff L. Plagge, on behalf of the American Banking Association.

²² NCUA News Release, www.ncua.gov/news/press_release/2005/NR05-0123.htm

²³ Public Law 416

²⁴ See Public Law 105-219, August 7, 1998, 112 STAT. 914

deposits, and it also requires banking regulators to examine and rate their level of service on a regular basis.

As legislative and regulatory changes over the years have broadened what products and services credit unions are permitted to offer to whom, the distinction between credit unions and other depositories has blurred in some ways and the extent to which credit unions uniquely serve people of modest means has come into question. Consumer advocates and the banking industry have lobbied for greater accountability and transparency in credit unions' service to low-income households, including enacting legislation to extend CRA to credit unions.

After the passage of CUMAA and in response to a request by the Senate Banking Committee, the Government Accountability Office evaluated six key issues in regard to credit unions, including the extent to which credit unions fulfill their mission of serving people of modest means. The GAO's analysis of the limited available data found that a slightly lower percentage of low and moderate income households primarily or only used credit unions, as compared to banks (36% v 42%, respectively.)²⁵ However, the GAO prefaced its comments by remarking that there is no comprehensive data on the income of credit union members, making it difficult to evaluate whether credit unions fulfill their mission. Thus, the GAO recommended that NCUA develop "tangible indicators, other than 'potential membership,'" to determine whether credit unions have provided greater access to savings and credit services to people in underserved areas.²⁶ In response to the GAO's recommendation, NCUA created a working group to analyze credit union's service to persons of modest means. As of October 15, 2005, NCUA has added programs to assist credit unions in serving people of modest means, but it has not acted on the GAO's recommendation to create indicators.

In 1999, under the leadership of then-Chairman, Norman D'Amours, the NCUA passed a regulation requiring that any type of application related to expanding, converting or chartering a community credit union address "in either its business or marketing plan..., how it plans on serving the entire community, including how the credit union will market to the community and what products and services will be offered by the credit union to assist underserved members in the community."²⁷

According to Norman D'Amours, it was politically very challenging to convince the other NCUA board members to approve this "community service plan," (which in itself was less stringent than the initial proposal to require a community *action* plan.) Only after several scheduled votes did the community service plan pass and the version which passed was so weak, according to D'Amours, that "no self-respecting researcher would give credence to [it]."²⁸ The industry mounted a major Congressional lobbying campaign against these initiatives, which, according to former Chairman D'Amours, had great influence over some of the NCUA board members.

²⁵ Government Accountability Office, Credit Unions Financial Condition has Improved but Opportunities Exist to Enhance Oversight and Share Insurance Management, October 2003

²⁶ *Ibid*

²⁷ 65 Fed. Reg. 64512, 64518, Oct. 27, 2000), as quoted in the National Community Reinvestment Coalition v. National Credit Union Administration, US District Court for the District of Columbia

²⁸ As quoted in "Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-income households," Jacob, Bush, Immergluck, Woodstock Institute, February 2002

Nevertheless, the community service plan ruling required all community chartered credit unions to submit to NCUA their plans for marketing to their entire field of membership by December 31, 2001. On December 20, 2001, however, the requirement was repealed. The composition of the Board had changed, and the new NCUA Chairman Dennis Dollar did not support the community service plan ruling. (The National Community Reinvestment Coalition—a member-based consumer advocacy non-profit organization which focuses on fair lending—subsequently sued the NCUA for repealing the regulation on procedural grounds, but the Court found that NCRC did not have standing and thus dismissed the case.)

Debbie Matz, an NCUA board member from January 2002 through September 2005, was similarly committed to helping credit unions outreach to more low-income households, but she approached the goal by working with and encouraging the industry in its own efforts. In speeches, Ms. Matz made a political and economic case for credit unions to serve low-income households within their fields of membership. She also created a program called Partnering and Leadership Successes (or PALS) to build the field's understanding of serving the low-income market through workshops, peer learning opportunities across the country, and the development of a clearinghouse of information on the NCUA's website.

RECENT CONGRESSIONAL OVERSIGHT & NCUA'S RESPONSE

On the Congressional side, in 2004 Representative Bill Thomas, Chairman of the Committee on Ways and Means, began investigating the rationale behind the tax exempt sector for industries such as hospitals and financial institutions. In November of 2005, the House Committee on Ways and Means held a hearing specifically on “the history of the tax exemption for credit unions to determine whether credit unions are serving the goals intended with their tax-exempt status.”²⁹ The hearing topics included:

- The history of and Congress' rationale for providing tax exemption to credit unions;
- Whether credit unions are serving the goals intended with their tax-exempt status;
- The use of the tax benefit by credit unions; and
- Changes in the credit union industry, including the growth in credit union membership and services.³⁰

Witnesses included representatives from NCUA (including former Chairman D'Amours and the current Chairwoman Johnson,) IRS, GAO, credit unions and their trade associations, banking trade associations, academics, and consumer advocates (e.g. National Community Reinvestment Coalition.) In its testimony, the GAO reiterated its 2003 report recommendation to develop indicators to evaluate credit union's performance in reaching the under-served population. While the transcript is not yet available, leaders in the field indicated that the conclusion of the hearing was to reaffirm the tax exempt status of credit unions but require some sort of documentation of their service to people of modest means.

²⁹ <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=4130>

³⁰ *Ibid*

Helping Credit Unions Serve Low-Income Communities

In response, the NCUA announced on November 30, 2005 that it is expanding the focus of its modest means working group—originally created in 2003 after the GAO’s study was released—to include: “transparency, definition of modest means, and the data gathering process demonstrating service to those members.”³¹ The study is expected to be completed within the first six months of 2006.

In February of 2006, the NCUA announced that it is beginning a process of collecting data on credit union membership and credit unions’ senior management compensation and benefits. To collect this data, NCUA plans on conducting two-day, on-site visits at 481 randomly selected federal credit unions with different types of federal charters. Specifically, NCUA will use this data to do an evaluation of:

- The extent and type of services provided to members;
- The income distribution of members
- The reliability and value of this preliminary data; and
- Executive compensation and benefits.³²

With this regulatory and political perspective in place, the next section discusses different standards by which to measure and evaluate credit union’s service to people of modest means.

³¹ NCUA News Release, November 30, 2005

³² NCUA Letter to Federal Credit Unions, Measuring Service, February 2006, <http://www.ncua.gov/letters/letters.html>



Summary of Section I Regulatory & Political Perspective

REGULATORY REVIEW

- Recent legislative and regulatory changes have enabled **credit unions to expand their geographic charters & serve more low-income households**
- **Focus of this Report: mainstream community credit unions and credit unions with underserved areas**

THE CREDIT UNIONS MISSION: LEGAL & POLITICAL PERSPECTIVE

- Credit unions were created and exempted from taxes in order to serve people of “small” or “modest” means
- There is no definition of, or standards for serving people of modest means
- In 2003, the **GAO**:
 - Found that credit unions serve a slightly lower percentage of low and moderate income households than banks, and
 - **Called for more data and tangible indicators to measure service to people in underserved areas**
- NCUA created a **Modest Means Working Group** & launched programs to help credit unions serve more low-income households
- NCUA tried unsuccessfully to pass regulations to document credit unions’ efforts in serving low-income households
- Credit union industry has resisted efforts to document service to low-income households and/or be subject to CRA

RECENT CONGRESSIONAL OVERSIGHT

- In November, 2005, the House Committee on Ways & Means held a **hearing** on “the history of the **tax exemption for credit unions** to determine whether credit unions are serving the goals intended with their tax exempt status”³³
- Hearing called for **documentation of service to low-income households**

NCUA’S RESPONSE

- On 11/30/05, NCUA expanded its **Modest Means Working Group** to include: “**transparency, definition of modest means, and the data gathering process demonstrating service to those members.**”³⁴
- **Working Group** is said to release a **report** within the first half of **2006**
- In 2/06, NCUA **begins collecting data** on credit union membership and credit unions’ senior management compensation and benefits

³³U.S. House of Representative Committee on Ways and Means Hearing, November 3, 2005, <http://waysandmeans.house.gov/hearings.asp?formmode=view&id=4130>

³⁴



Section Two

PERFORMANCE MEASURES & DATA COLLECTION: *Outcome-based v Effort-based Standards?*

While credit unions were established primarily to serve people of modest means, as mentioned earlier, there are no special measures by which credit unions are evaluated on fulfilling this mission.

Credit unions could be measured on either their effort made in trying to serve low-income households (e.g. branches in low-income areas, partnerships with community-based organizations, cultural and linguistic capacity of staff) and/or by their outcome in serving low-income households (e.g. percentage of low-income households with checking/saving accounts, number of and approval rates for consumer loans, number of and approval rates for home loans, etc.)

The literature in the field includes previous attempts to measure performance, at times by outcome and at other times by effort, with mixed results. The few independent outcome-based analyses – most notably a report by the GAO – conclude that a) more data is needed to understand more fully the extent to which credit unions serve low-income households and b) the existing available data suggest that credit unions serve fewer low-income households than banks serve low-income households or than credit unions serve higher income households. Studies conducted by advocacy organizations support the view that banks outperform credit unions in their service to low-income households. On the other hand, studies funded by industry trade associations and their research wings indicate that credit unions serve more low-income households than banks. (Refer to Appendix B for a summary of these studies.)

Other reports describe effort-based approaches to credit union performance. These profiles, also summarized in Appendix B, describe the initiatives of credit unions to partner with community-based organizations, add branches in low-income areas, and develop innovative products to meet the needs of low-income households. However, just as more data is needed to assess industry-wide outcomes for credit unions, so too is more data needed to assess industry-wide efforts of credit unions. Data could be collected on either outcome or effort.

As the NCUA grapples with developing indicators to demonstrate credit unions' service to people of modest means, this section discusses the question of whether credit unions should be judged by their effort, by their outcome, or by both. Culled from interviews with the leaders in the field, below are some arguments for and against outcome- and effort-based performance standards.

1. Arguments for an Effort Approach/Against an Outcome Approach

A. *Too Soon to Measure Outcomes of Community Charters & Adopted Underserved Areas*

For most of credit unions' 64-year history, mainstream credit unions were tied to occupational fields of membership. It is only within the past several years that many credit unions gained the ability to reach out to all segments of the income distribution through community charters and the adoption of low-income areas. Credit unions, according to industry leaders, need time



to penetrate the market and test out products and services for lower income people before being judged on their outcome. “At some point an evolution from efforts to outcomes may happen,” advised one credit union leader, “but to suggest outcomes and accountability now would be a huge error.”

B. An Outcome Approach is Unnecessary & Costly

Other opponents of an outcome-based approach argue the opposite: these leaders contend that credit unions already serve a larger percentage of low- and moderate-income people than banking institutions and they point to industry studies for support. An outcome-based approach is thus not only unnecessary, according to the industry, but it would also require costly and burdensome data collection procedures. (Refer to Subsection #4 below for further discussion of data collection.)

C. One Size Doesn't Fit All / No Agreement on the Outcome

Each credit union is unique, with a distinct field of membership. It would be impossible to determine an outcome standard, according to this line of argument, which is fair, agreeable to everyone, and takes the relevant distinctions into account. For example, the majority of credit unions are occupationally-based and could not therefore be held to a community standard. If, on the other hand, the outcome standard only applied to credit unions with a community charter or an underserved area, then credit unions may be deterred from converting to a community charter or adding an underserved area to the field of membership. The costs may outweigh the benefits, these leaders contend.

There is also no agreement within the industry on the outcome or the actions to be taken if the outcome is not met. Even if an outcome standard based on a specific field of membership could be established and agreed upon, credit unions' field of membership are constantly changing, according to these critics, so in practice the standard would not be implementable.

2. Arguments in Favor of Outcome / Against an Effort Approach

A. Effort Isn't and Hasn't Been Enough

Given their tax exempt status and historical mission, proponents of an outcome based approach argue that it is simply not enough for credit unions to make an effort without demonstrating the result of that effort. An effort-based approach, by definition, makes it more difficult to measure the extent to which credit unions actually provide products and services to low-income households.

Based on the limited available data, those in favor of outcomes argue, an effort-based approach to date has not been sufficient in motivating the industry as a whole to serve low-income households. “We want the outcomes,” as one credit union leader put it, “we don't want people just to be doing it for the sake of it.” These outcomes proponents point to studies by the GAO and advocacy organizations which demonstrate that credit unions serve fewer low- and moderate-income households than banks.

B. Provides Transparency & Indicators for Industry Managers

In the face of criticism for not doing “enough,” a clearly articulated outcome-based standard allows the industry and its managers to know what is expected of them and when they have met or exceeded that expectation. “We're focused on results,” as one credit union leader put

it, “you want what done by when? If you can’t tell me what enough is, I’m afraid to play the game....I don’t have a grip on when I’ve achieved something or not achieved something.”

C. *Small Numerical Outcome Goals Can Make a Big Difference*

Another credit union leader argued that outcomes are needed to overcome the initial institutional hurdle of outreaching to a new market. Once that hurdle is crossed and credit unions start to understand the need, identify the right employees to work on it and the right community contacts, it then becomes easier to grow from that initial seed effort. Even a small outcome target would be sufficient to motivate credit unions do to that institutional outreach and yield greater results over time, according to this leader.

3. Which Outcome- or Effort-based Standard Should Credit Unions Adopt?

If an outcome- or effort-based approach were to be adopted, one of the challenges lies in coming to agreement on a reasonable standard to apply. Given that this is a lengthy and controversial topic in and of itself, the following are a few options for consideration and later discussion.

Examples of Outcome-based Standards:

- A new “*Proportionality Standard*”: credit union membership and product usage should reflect the income distribution of the *entire* field of potential members, so, for example, if 30% of the people in a credit union’s field of membership are “low-income,” then 30% of that credit unions’ membership and product usage should also be low-income.
 - Low-income could be defined as 80% or lower of the area median income, by the state-calculated self-sufficiency standards, or other governmental definitions.
- *Some Proportion of the Proportionality Standard*: for example, if 30% of the people in a credit union’s field of membership are “low-income,” then, say, 15% of that credit unions’ membership and product usage should also be low-income.
- *National CRA*: The standard currently applied to banks under CRA.
- *State CRAs*: The standard applied to state-chartered credit unions in the few states which have enacted a CRA law for credit unions.

To address concerns that community credit unions and credit unions with underserved areas need more time before being evaluated by outcome, the standard could be phased in over time (e.g. 3-5 years after charter approval.)

Examples of Effort-Based Standards

- *Availability of Affordable Products & Services*: the NCUA could develop a list of appropriate and affordable products and services for low-income households and then evaluate credit unions on the availability of products and services geared toward low-income households.
- *Accessibility of Community Chartered Credit Unions*: the NCUA already requires that credit unions which adopt an underserved area open a branch within two years of approval. A distribution of branches requirement could apply to community charters. Credit unions could also be evaluated by other accessibility measures, for example, the language capacity of staff, hours of operation, amount of non-automated service.

- *Efforts to Connect to the Community:* for example, number of meetings with community and business leaders, advertisements in local media, multi-lingual marketing materials, financial education seminars, etc.

4. Data Collection

If either an outcome- or effort-based standard were to be adopted, more data would need to be collected. This next sub-section presents arguments for and against increased data collection and possible data collection methods.

Arguments Against Increased Data Collection

A. Capacity, Cost & Burden

Some credit union leaders argue that credit unions do not currently have the capacity to collect income-related data on their membership or product usage. Increased data requirements would be particularly costly and burdensome for small credit unions to develop.

B. Invasion of Privacy, Impediment to Joining

Credit union leaders also argue that it is an invasion of privacy for every member applicant to provide information on their income. The membership requirement is already an impediment to receiving credit union services; adding another layer of forms to be completed would only further deter membership (especially, perhaps for the unbanked, many of whom are already distrustful of financial institutions.)

C. First Step Toward Outcome Mandates

Those who argue against an outcome-based standard are usually also opposed to data collection because they view data collection as the first step toward mandating outcome-related goals. “The government won’t implement documentation,” asserted one leader, “without some type of quota down the road,” the inference being: otherwise, why would they bother to collect the data?

D. Fear of What the Data Will Reveal

Some leaders point out that credit unions do not want to collect data because they fear the data will reveal under-service to low-income households. This concern may be greatest among community-chartered credit unions—many of whom only converted to a community charter over the past several years—and may not have had sufficient time to demonstrate sufficient outcomes.

E. No Agreement on Which Data

Just as there is no agreement among industry leaders on appropriate standards, neither is there agreement on what data should be collected and how. This challenge is exacerbated by the individual differences among credit unions, which makes uniformity in reporting nearly impossible and aggregating the data therefore meaningless, according to one critic.

Arguments in Favor of Increased Data Collection

A. Cannot Answer the Question Without the Data

While the Home Mortgage Disclosure Act (HMDA) requires data collection on home lending for credit unions with assets over \$34 million, many credit unions are exempt because of their

size, and there is no data collection requirement on transactional services, consumer loans or other products.³⁵ Proponents of increased data collection—including the GAO and the Woodstock Institute—argue that it is impossible to measure the extent to which credit unions are fulfilling their historic mission to help people of modest means save and access credit without increased data collection. Richard Hillman from the GAO stated in his recent testimony to the House Committee on Ways and Means, “the extent to which credit unions serve persons of modest means is not definitively known because of limited data and lack of indicators.” In fact, the GAO previously recommended in its 2003 report to the Senate Committee on Banking that the NCUA develop “tangible indicators other than ‘potential membership’”³⁶ to answer this question, but the recommendation has not yet been implemented.

B. Data Collection, Itself, May Motivate Change

Some argue that more publicly available data could be enough—even without standards attached to that data—to catalyze industry-wide improvement in serving low-income households. Advocates could use publicly available data to put pressure on credit unions where, for example, the income distribution of their membership is much higher than the income distribution of the area in which they are chartered to serve. The public data may also inspire greater competition among credit unions to “look good” in serving low-income communities and thus yield greater industry-wide results.

C. Political Capital

Credit unions face political pressure both from the banking industry and consumer advocates to “earn” their tax exemption by serving more low-income households and communities. Some argue that credit unions should increase their data collection as a political strategy to protect their tax exempt status. Collecting the data in and of itself would build political capital. If the data demonstrates, as some argue, that credit unions already disproportionately serve people of modest means, the industry would gain that much more political support in protecting their status.

5. Data Collection Methods: If Data Is Needed, How Will It Be Collected?

Coming to a consensus on the need to increase data collection is one challenge; determining which data to collect and how to collect it is another. Which data to collect depends on whether an outcome-based or effort-based standard is adopted. Examples of outcome-based data include income of members or product usage by income; examples of effort-based data include the distribution of branches, types of affordable products and services, and attendance at community outreach events, etc.

Below are a few ideas from the leaders interviewed on data collection and methods, any one of which requires further exploration.

- *Federal Mandate:* NCUA could mandate that credit unions report on membership and product usage by income and/or efforts to reach out to low-

³⁵ The Home Mortgage Disclosure Act (HMDA), enacted by Congress in 1975 and implemented by the Federal Reserve Board, requires lending institutions to report public data.

³⁶ U.S. House of Representative Committee on Ways and Means Hearing, November 3, 2005, Testimony of Richard J. Hillman, U.S. Governmental Accountability Office



- income households. (Previously, it was proposed that NCUA mail an annual mandatory membership survey to all federally insured credit unions.)
- To address concerns that collecting income data on membership is costly, burdensome, and invasive, credit unions could add a simple line on the membership application asking whether the applicant makes above or below the “low-income” cut-off mark. After that point, income data could be aggregated only when members apply for loans.
 - Credit unions could analyze its membership by zip codes and/or occupational salaries to approximate members’ income.
 - *Survey Research Centers:* Public or private sources could fund existing survey research centers to add questions regarding credit union membership and product usage to their periodic surveys of households (e.g. Survey of Income and Program Participation (SIPP,) or Panel Study on Income Dynamics (PSID)).
 - *Private Companies (e.g. Raddon Financial Group):* Many credit unions already contract with Raddon Financial Group, a data-base and data analysis company, to collect and analyze membership and services of credit unions. Credit unions could be required to report this data publicly.
 - *Voluntary Industry Initiatives (e.g. similar to the CDFI Data Project):*³⁷ The credit union industry could voluntary develop a more stringent data collection process and make that data publicly available. The CDFI Data Project is an industry collaborative initiative to create a data collection and management system that produces high quality, comprehensive data about the community development finance field. About half of the approximately 1,000 CDFIs participate.

³⁷ Funded through the U.S. Department of Treasury, Community Development Finance Institutions (CDFIs) are specialized financial institutions that work in areas underserved by traditional financial institutions.

Summary of Section II

Performance Measures & Data Collection

ARGUMENTS FOR AN EFFORT APPROACH/AGAINST AN OUTCOME APPROACH

- Too Soon to Measure Outcome of Community Charters & Adopted Underserved Areas
- An Outcome Approach is Unnecessary & Costly
- One Size Doesn't Fit All / No Agreement on the Outcome

ARGUMENTS IN FAVOR OF OUTCOME, AGAINST AN EFFORT APPROACH

- Effort Isn't and Hasn't been Enough
- Provides Transparency & Indicators for Industry Managers
- Small Numerical Outcome Goals Can Make a Big Difference

WHICH OUTCOME- OR EFFORT-BASED STANDARD SHOULD CREDIT UNIONS ADOPT?

Examples of Outcome-based Standards

- Proportionality Standard
- Some Proportion of the Proportionality Standard
- CRA

Examples of Effort-Based Standards

- Availability of Affordable Products & Services
- Accessibility of Community Chartered Credit Unions
- Efforts to Connect to the Community

ARGUMENTS AGAINST INCREASED DATA COLLECTION

- Capacity, Cost & Burden
- Invasion of Privacy, Impediment to Joining
- First Step Toward Outcome Mandates
- Fear of What the Data Will Reveal
- No Agreement on Which Data

ARGUMENTS IN FAVOR OF INCREASED DATA COLLECTION

- Cannot Answer the Question Without the Data
- Data Collection, Itself, May Motivate Change
- Political Capital

HOW TO COLLECT THE DATA?

- Federal Mandate
- Survey Research Centers
- Private Companies
- Voluntary Industry Initiatives

Section Three

CHALLENGES IN SERVING LOW-INCOME HOUSEHOLDS

To review: Section I outlined recent regulatory and legal changes which have enabled credit unions to serve larger areas and add underserved areas. It also discussed political and regulatory initiatives to measure credit unions' performance in serving low-income households. Section II discussed effort- versus outcome-based standards of performance measurement as well as data collection issues. Delving more deeply into the qualitative findings from the stakeholder interviews, we are now ready to analyze the many challenges involved in marketing to and serving low-income households and communities. While legislative and regulatory changes removed legal barriers, mainstream credit unions still face strategic, financial, and regulatory challenges in marketing to and successfully serving low-income households.

1. Strategic Concerns

A. *“Heart is there but the learning curve is huge:” Credit Unions Are New to the Market*

Leaders in the credit union industry argue that the legal authority of credit unions to serve all members of a community is a relatively recent phenomenon over the past several years; these credit unions are just beginning to learn how to do it. Many credit union leaders initially thought that once their credit union converted to a community charter or added an underserved area, low-income households would quickly recognize the financial benefits of credit unions and simply walk through the door. There was, some said, a “build it and they will come,” attitude. One leader of a community development credit union reported:

“I get calls from mainstream credit unions which say: ‘I just changed my field of membership and now I got this low-income membership. What should I do?’”

Many mainstream credit unions soon learned that they needed to be strategic in their outreach to low-income markets, build partnerships with local leaders and community-based organizations, learn from low-income credit unions, and provide culturally and linguistically appropriate staff.

B. *Harder to Penetrate a Community Than an Occupation or Association*

Unlike other types of financial institutions, occupationally-based credit unions never needed to develop a sophisticated market segmentation analysis because their membership was limited to particular employees. It is much harder to penetrate a community, according to one credit union CEO, than an occupational group, in which access is made easy through the human resource department and employee meetings. Compared to single group credit unions, multiple group and community chartered credit unions do not understand their full field of membership. For low-income communities, mainstream credit unions must learn more about:

- Market access and trust points,
- Which products, services and programs work and why,
- Cultural and linguistic characteristics of their communities,
- How underserved communities currently conduct transactional services, and the
- Costs associated with targeted service to low-income areas.



C. Time, Patience & Product Differentiation

Penetrating a low-income market takes time and patience; some credit unions tried and became frustrated when the efforts did not yield quick results, according to some credit union leaders. A consultant to the field added that the egalitarian ethos of credit unions may be a barrier—especially for smaller credit unions—to product differentiation or charging for a la carte items such as money orders or cashing checks.

D. Lack of Focus Within the Industry

A few leaders argued that there is a lack of focus within the industry and its trade associations on promoting outreach to low-income populations—perhaps because they do not view this as a priority within their membership. Others defend the trade association by arguing that it has taken initiatives to document service to people of modest means (through a program called Project Differentiation), create a credit union loan pool for first-time home buyers and promote this issue publicly.

E. Lack of Focus by Individual Credit Unions

At the individual credit union level, some suggested that credit unions are most concerned about financial stability and competitive growth, rather than expanding into a low-income, “risky” market which is not profitable in the short-run and may not be profitable in the long-run. According to these critics, there is a new generation of credit unions leaders (some of whom are former bankers) who have not adopted the credit union mission of serving people of modest means. In a less critical twist, a few argued that credit unions are simply more conservative and less entrepreneurial by nature than for-profit institutions so they are less likely to expand into a low-income market.

F. Perceptual Effect on Other Members

Still other leaders reported that credit unions may be concerned about the perceptual effect that serving more low-income households could have on existing members. Because credit unions are cooperatively owned, there is a strong allegiance to existing members and a commitment to providing a return for those members. Additionally, many more low-income households at the credit union may be perceived as “hurting the service culture,” according to one leader.

2. Financial Concerns

A. Costs

The costs associated with targeting and serving a low-income market also pose challenges for credit unions. Some of the costs include:

- Opening a bank branch in a low-income neighborhood with convenient hours and proper security;
- Building relationships with community leaders;
- Marketing in the ethnic press; and
- Identifying and developing (if need be) appropriate products and services for low-income households.

The higher reserve requirement for credit unions combined with their inability to raise capital

on the secondary market makes it particularly hard for credit unions to build new branches, according to one leader.

B. Longer Yield on Return / “Diseconomies of Scale”

Providing financial services to a low-income market can yield a longer return on investment. One leader described a “diseconomies of scale” issue: “high cost, low value members” make frequent and small deposits, increasing transactional costs, while taking out smaller but riskier loans. Labor costs include culturally and linguistically appropriate staff as well as capacity to handle more in-person as opposed to automated transactions and financial education. Longer term financial planning and risk-based lending is more important, according to a few leaders, in targeting a low-income market.

C. Profitable, Nonetheless

Despite these costs, most stakeholders and some studies argue that service to low-income households can be profitable, especially if credit unions offer transactional products and services similar to those of the alternative financial sector (but priced at lower rates) in high volumes and make loans prudently. One industry leader insisted:

“Serving low- to moderate-income people is profitable,” insisted one leader, “Any financial institution which doesn’t see the potential in these emerging markets is missing the boat!” Another leader said that his credit union’s alternative pay day lending product is among its most profitable products. Two related studies funded by Filene Research Institute—a non-profit research center which examines issues affecting the future of credit unions and consumer finance—also conclude that despite some misconceptions, raising the percentage of low-to-moderate income households is a good business proposition, which can also benefit existing credit union members: “[i]n fact, net income was higher among the credit unions with lower income members.”³⁸ Other leaders point out, however, that it is challenging to be financially self-sustaining (without grants/subsidies) if the majority of the membership is low-income but easy to do if the credit union has an economically diversified demographic.

3. Regulatory Concerns

A. Perception of Risk and Regulatory Downgrading

While most of the credit union leaders interviewed believed that expanding service to low-income households can be profitable, many leaders also acknowledged a common perception—especially among some credit union board members—that servicing low-income households is “riskier:” loan delinquency rates, charge-offs and operating expenses will rise, while net income and overall financial ratios will decline. This decline in financial ratios will result in a downgraded regulatory rating, according to this line of reasoning. One credit union leader said:

“No CEO will go into low-income areas, if he perceives that he’ll have regulatory backlash...the regulator needs to lay back a bit or we won’t ever be able to serve this market to the fullest extent.”

³⁸ “Effects of Member Income Levels on Credit Union Financial Performance,” Lambrinos and Kelly, p. 37
“Strategic Opportunities in Serving Low to Moderate Income Members,” Burger and Zellmer, Filene Research Institute. Note: Filene Research Institute receives funding from the credit union industry association.

The important point here is that even if serving more low-income households *is* or could be profitable and thus does *not* result in lower overall financials or a regulatory downgrade, the (mis)perception to the contrary is a barrier to expanding into this market that needs to be addressed.

B. NCUA Examiners Need to Lay-Off

A few credit union leaders commented that even if a credit union's financial ratios do decline as a result of outreaching and providing services to low-income communities, NCUA examiners should be a little more lenient in their examinations, especially if that credit union can absorb a temporary loss. In other words, if NCUA really wants credit unions to serve this market, it cannot punish them regulatorily for doing so. One leader reported that he heard too many anecdotes about regulators in the field criticizing credit unions in front of their boards for making riskier loans. There is often a disconnect, according to some, between the NCUA leadership and the on-the-ground examiners. While NCUA publicly promotes service to low-income communities, individual examiners face pressure to make sure that those credit unions under their jurisdiction remain fiscally sound: "no examiner wants a credit union to go under, under his watch," one leader cautioned.

C. Restrictions on Non-Member Products & Services

Restrictions on products and services to non-members make it more difficult to market to the unbanked population because, according to this argument, credit unions need to engage the unbanked with "relationship building products" (such as remittances, check cashing services, etc.) in order to foster trust and eventually transition them into the financial mainstream. But credit unions cannot offer these products to the unbanked people without their becoming members first.

D. Restrictions on Interest Rates, Loans, & Types of Services

Regulatory restrictions on interest rates, loans and types of services may make it difficult for credit unions to target products and services to the unbanked population as well, contend some credit union leaders. For example, there is 18% federal usury limit on credit union loans. Some suggested that if credit unions could charge up to 25-30%, more credit unions would offer alternatives to pay day loans because it would be more profitable to do so. There are also regulatory restrictions on the percentage of permitted small business loans (12.25% of total assets, if the business loan is over \$50,000) which prevent credit unions from doing more small business lending, a potential source of growth and profitability in low-income areas.

On the other hand, leaders in the community development credit union field—who only serve low-income households—dismissed this argument by countering that for years they have been able to provide appropriate products and services to low-income households without lifting regulatory restrictions or requiring greater leniency on regulatory examinations. Why can't the mainstream credit unions do the same?

4. Best Practices

Despite all of these challenges, some credit union leaders have made enormous strides in meeting the financial needs of low-income households. Mainstream credit unions have formed partnerships with local community-based organizations to open branches in low-income areas. Others have developed profitable alternatives to payday lending which include a built-in savings component. Some credit unions have volunteered at and enrolled new

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members at free tax assistance sites. Other credit unions have joined forces in setting up credit union service organizations (CUSOs) to make it more financially viable to serve low-income communities by sharing the costs and spreading the risks among several credit unions. One credit union even opened a branch to serve underserved Amish residents in rural Wisconsin and provided a hitching post for their horses. Since best practices are not the focus of this report and have already been researched to some extent, we just list a few here, but refer to Appendix B for a more detailed summary of the literature on best practices.



Summary of Section III

Challenges in Serving Low-Income Households

STRATEGIC CONCERNS

- “Heart is there but the learning curve is huge”
- Harder to Penetrate a Community Than an Occupation or Association
- Time, Patience & Product Differentiation
- Lack of Focus Within the Industry
- Lack of Focus by Individual Credit Unions
- Perceptual Effect on Other Members

FINANCIAL CONCERNS

- Costs
- Longer Yield on Return / “Diseconomies of Scale”
- Profitable, Nonetheless!

REGULATORY CONCERNS

- Perception of Risk and Regulatory Downgrading
- NCUA Examiners Need to Lay-Off
- Restrictions on Non-Member Products & Services
- Restrictions on Interest Rates, Loans, & Types of Services



Section Four

STRATEGIES

To Help Credit Unions Overcome the Challenges

Given all the challenges associated with financially serving low-income households and communities, what are some strategies to help credit unions overcome these challenges and motivate more credit unions to serve this market? This section presents “carrot” and “stick” approaches to provide incentives so that more credit unions reach out to the low-income households within their fields of membership.

Carrot Approach

A. Address the Knowledge Gap: Build the Field Building

Several of the credit union leaders reported that mainstream credit unions needed to develop a better understanding of how to serve low-income populations. At the same time, credit unions tend to trust each other, share knowledge, and learn from one another. “If they talked to a peer who has successfully done something,” one industry leader noted, “that goes miles to convincing others to do something.” Thus, one strategy is to promote and fund field building and peer learning opportunities both among mainstream credit unions and between mainstream credit unions and community development credit unions. This strategy would support intermediaries in the field to:

- Provide one-on-one technical assistance;
- Develop and help apply successful financial models for serving low-income households;
- Connect mainstream credit unions to community development credit unions and community-based organizations;
- Research and test the right mix of products and services for low-income households;
- Develop and promote toolkits and knowledge centers; and
- Aggregate, promote and disseminate best practices.

Some of the intermediaries in the field are already doing this work. This strategy would build upon those efforts. (A few leaders emphasized the importance of putting the existing information and tools *into practice* through *in-depth technical assistance*, rather than creating new tools or broad-based best practices studies.)

Other strategic concerns within the industry could also be addressed through education, such as:

- Educating the new generation of credit union CEOs about the core mission of credit unions;
- Educating credit union leaders and their boards about how to discern risky v. reliable low-income borrowers;



- Dispelling perceptions about the effect serving low-income households would have on existing credit union members; and
- Demonstrating the benefits of product and service differentiation.

Some industry leaders agree that credit unions need greater assistance and education in providing financial services to low-income households, but argue that the existing intermediaries are not best-suited to do it because they are not specifically focused on credit unions' service to low-income households.

B. Create an Association of Credit Unions Interested in Reaching out to Low-income households

A second strategy is to create a new independent association of a few very large credit unions, several mid-sized credit unions, and many small and community development credit unions which have a common commitment to serving low-income households.

According to its proponents, the rationale for creating a new organization is three-fold:

1. Mainstream credit unions interested in serving low-income households need an association that focuses specifically on helping credit unions extend into this market. (The current associations have a broader mission and represent member credit unions which have many other competing needs.)³⁹
2. An alternative association would catalyze other credit unions to serve low-income households.
3. An alternative association would build an infrastructure for political and regulatory reform to provide positive incentives as well as accountability mechanisms.

The purpose of this association would be to offer technical assistance, best practices, back office support, nonmember deposits and mentoring to support mid-sized and large mainstream credit unions which want to expand into serving low-income households and smaller credit unions already serving this market. This organization would provide research to show that it is financially feasible to provide fairly priced financial services to low-income households.

Some proponents said that the association could also promote public policies to 1) to track and measure service to low-income households; and 2) link regulatory benefits to meeting measured performance of service to low-income households, while advocating against 1) current pressures on mid-sized and small credit unions to “grow or perish” and 2) predatory lending practices in the alternative financial sector. Ultimately, these kinds of policy decisions would be made by the association's members.

Despite the rationale cited by proponents of this strategy, critics argue that there are enough associations in the credit union industry competing for membership and financial support. It would be more prudent and cost-efficient to build the capacity and reform, if necessary, the existing intermediaries to serve the needs of credit unions interested in helping low-income households. Other opponents argue that this strategy could be divisive at a time when it is politically necessary to build a coalition around serving those of modest means. Another leader

³⁹ The National Federation of Community Development Credit Unions focuses explicitly on helping credit unions serve low-income households but its membership is comprised of community development credit unions, rather than mainstream credit unions.

said that the existing association of community development credit unions may be moving in this direction already.

C. Address the Financial Concerns: Subsidize the Costs & Reward Good Behavior

Another strategy is to subsidize the costs associated with marketing to and serving a low income market by allowing mainstream credit unions to receive nonmember deposits and grants, and/or secondary capital authority. A public or private entity could likewise underwrite the costs of conducting market research and then developing new, targeted products for low-income households. In addition, NCUA could offer secondary capital authority as a reward for credit unions which meet a certain standard of excellence.

To encourage competition, provide public recognition and help subsidize the costs, a public or private entity could offer publicly-awarded financial or other prizes (similar to CDFI's Bank Enterprise Awards) to credit unions which excel in their service to the low-income households within their fields of membership.⁴⁰

D. Address the Regulatory Concerns: Relief on Restrictions, Some Leniency on Exams, and Rewards for Excellence

A regulatory “carrot” approach consists of providing regulatory relief and some leniency to make it easier for credit unions to serve low-income households and/or using regulatory relief as a reward to those credit unions which meet a standard of excellence in serving low-income households within a credit union’s field of membership.

Regulatory relief also includes some leniency on regulatory examinations for those credit unions which take a temporary financial loss while extending service to those of modest means, especially if the credit union can absorb the loss in the short-term. The message from NCUA leadership must permeate through to the on-the-ground examiners, so that the policies and “rules of engagement” for reaching out to low-income households are clearly articulated and credit unions are not criticized in their examinations for following those rules. The NCUA could instruct and train its examiners, for example, to allow credit unions with high capital ratios to experience lower returns on investments and declining capital ratios as these credit unions make investments in programs for low-income households, without resulting in a downgraded rating. NCUA could also address the incentive (if true) for examiners to be fairly conservative in their rating so that “their” credit unions stay afloat financially.

Other types of regulatory relief could address the restrictions on services to non-members to allow credit unions to offer certain “relationship building” products (e.g. check-cashing services, remittances, bill paying services)—perhaps for a specified period of time—to non-member, unbanked individuals within the credit union’s field of membership. These products and services would engage the unbanked and provide an opportunity to build a relationship which leads them to the financial mainstream. Similarly, restrictions on interest rates could be adjusted so that credit unions can more easily target products and services to people now using

⁴⁰ The Community Development Finance Institution Fund provides insured depository institutions financial incentives to expand investments in CDFIs and to increase lending, investment, and service activities within economically Distressed Communities (as defined by the authorizing legislation.) The Bank Enterprise Award is one of three strategies used by the Fund to provide an incentive for banks to invest in low-income and under-served communities. Credit unions are not eligible to receive this award, which can offset the costs of opening a branch in a low-income area.

the alternative financial services. Some leaders argue that it is not profitable for credit unions to offer an alternative pay day lending product at an 18% maximum interest rate. (Others, however, argue that there are no regulatory barriers to entry for the core transactional products most important to low-income households.)

One leader in the field suggested that NCUA streamline regulatory approval processes and requirements as a reward for those credit unions which provide income-related data on membership and product usage and then demonstrate through that data excellence in service to low-income households. Another leader suggested lowering the 7% of total assets reserve requirement so that credit unions have a greater source of capital to build branches in low-income areas. Finally, another suggestion was to raise the percentage of permitted small business loans to encourage more commercial lending in revitalizing low-income areas.

E. Address the Strategic Concerns: Publicly Promote Excellence, Tie Tax Exemption to Excellence, Educate Credit Unions on How to Serve Low-Income Populations

To address the concern about the industry's focus on promoting outreach to low-income populations, the industry could encourage and publicly promote credit unions which increase their service to low-income households. Working with community groups, one credit union leader suggested that the industry create a list of products and services most important to low-income households, as well as target goals for serving low-income households, and then distribute a "good housekeeping" seal of excellence for those credit unions which both offer the products and services and meet the goals. Others suggested that industry focus would be enhanced by tying credit unions' tax exemption to a well-defined standard of service to low-income households.

Stick Approach

Some advocates argue that financial, regulatory, and field building incentives are not enough to catalyze industry-wide change; rather, outcome-based goals and enforcement mechanisms are necessary.

A. New Regulatory Requirements for Community Credit Unions and Credit Unions With Underserved Areas

Some argue that NCUA should create specific requirements as a condition for receiving and maintaining a community charter or adopting an underserved area. These requirements could include any one—or combination of—the following for community-chartered credit unions and credit unions with underserved areas:

1. Create a plan to outreach to low-income households within their field of potential membership;
2. Track efforts to outreach to low-income households;
3. Collect and aggregate income-related data on credit union membership and product usage;
4. After a period of time, comply with minimum effort-based standards in reaching out to low-income households; and/or
5. After a period of time, comply with minimum outcome-based standards in serving low-income households.

In support of this approach, one proponent argued:



There have to be stricter rules around the goals for granting community charter. It's fine to get this charter but if one-fourth of the people in your field of membership are low-income, then you need to get one-fourth low-income households in your field of membership within, say, three years...and the goals need to be realistic – with an expectation that 'we're going to check.'

As this observer noted, if any of these requirements were adopted, NCUA would have to create enforcement mechanisms to monitor compliance. Refer to Section II for a discussion of reasonable effort- or outcome-based standards.

Similarly, another leader of a credit union suggested that an “S” for a service rating be added to NCUA’s regulatory CAMEL(S) review for all credit unions, arguing that credit unions listen to their regulator and that this type of mechanism would considerably prod them to do more to bring low-income households into their field of membership.

In the spirit of a transparent and democratically-controlled institution, another leader recommended that credit unions should be required to annually report efforts and outcomes related to serving low-income households to their members. If a minimum standard were tied to this reporting mechanism and the report were made publicly available, this leader suggested that there would be an incentive to exceed that minimum standard. Because the credit union board of directors would know that this information is being reported, there would also be stronger buy-in, accountability, and public oversight of efforts.

Perhaps the strongest mechanisms, suggested by only a few leaders, would be not only to link regulatory approvals to outcome-based performance measures, but to also link a credit union’s tax exempt status and/or the provision of federal insurance to outcome-based performance.

B. Enact a National CRA Law for Credit Unions

A related but distinct strategy would be to support existing advocacy efforts to enact legislation to apply the Community Reinvestment Act (CRA) law to credit unions. Proponents of this approach argue that if credit unions are allowed to serve large geographic areas with half a million members and hold billions of dollars in assets, they should be subject to the same community reinvestment requirements as banks. Supporters point to the tremendous success of CRA in motivating banks to lend and invest billions of dollars in low-income communities, as well as the profitability of these loans and the reduction in subprime lending disparities resulting from CRA. Supporting this view, the National Community Reinvestment Coalition (NCRC) studied the effect of one of the few state-enacted CRA laws: it compared the performance of state-chartered credit unions in Massachusetts to federally-chartered credit unions. After three years of tracking performance, NCRC found that credit unions subject to CRA outperformed federally-chartered credit unions in loans made to low- and moderate-income borrowers, among other portfolio-share indicators.⁴¹ (Refer to the Appendix B for more details on this study.)

In sum, ranging from financial rewards to federal mandates, there are extremely divergent approaches to the most effective means of motivating mainstream credit unions to serve more

⁴¹ “Credit Unions: True to their Mission?” National Community Reinvestment Coalition, 2005

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low-income households. The next section provides an analysis of the advantages and disadvantages of these various strategies.



Summary of Section IV

Strategies to Help Credit Unions Overcome the Challenges

CARROT APPROACH

Address the Knowledge Gap: Build & Educate the Field on How to Serve Low-Income Populations

Address the Lack of Industry Focus

- Create an Association of Credit Unions Interested in Reaching out to Low-income households
- Publicly Promote Excellence in Service to Low-income Households
- Tie Tax Exemption to a Standard of Service

Address the Financial Concerns

- Subsidize the Costs
- Reward Good Behavior

Address the Regulatory Concerns

- Relief on Regulatory Restrictions
- Some Leniency on Regulatory Exams
- Regulatory Rewards for Excellent Service

Address the Strategic Concerns

- Publicly Promote Excellence
- Tie Tax Exemption to Excellence

STICK APPROACH

- New Regulatory Requirements for Community Credit Unions and Credit Unions With Underserved Areas
- Enact a National CRA Law for Credit Unions



Section Five

ANALYSIS OF STRATEGIES

I. Arguments in Favor of a “Carrot” Approach / Against a “Stick” Approach

A. *Credit Unions Already Serve Low-Income Households*

Some leaders in the credit union field argue that a stick approach is not necessary because credit unions already serve low-income households. They point to anecdotal evidence from individual credit unions as well as a few industry-funded studies which show that credit unions serve more low- and moderate-income households than banks. (Refer to Appendix B for a review of these studies.)

B. *What’s Needed is Help, Not Mandates*

Other leaders in favor of a carrot approach say that the problem does not lie in lack of motivation, as a stick approach would imply. Many credit unions already serve this market. Others want to increase their market share of low-income households but they need financial, regulatory, and technical assistance to overcome the many barriers discussed in Section III. When credit unions are given the opportunity to increase their knowledge of serving low-income households and communities, they take advantage of those opportunities and improve their strategies. For example, sixty-seven credit unions in three target states signed up to be partners in Filene Research Institute’s REAL Solutions pilot program to help credit unions and credit union leagues develop and promote appropriate products and services for low-income and low-wealth households in their respective states. Similarly, through a Ford-funded grant to the National Federation of Community Development Credit Unions, thirty mainstream credit unions are partnering with community development credit unions to learn about strategies to better serve low-income communities. As one leader in the field described, “It’s not about ‘ought to’s’ and ‘shoulds,’ but rather ‘here’s how.’” If more of these “how-to” programs were in place, more credit unions would be able to take advantage of these opportunities, resulting in an increase in membership among low-income households.

C. *Voluntary Action Yields Better Results*

Others in favor of a carrot approach argue that voluntary action actually yields better results. A more effective means toward behavioral change stems from working with, rather than against those agents of change. If the government mandates that credit unions *have* to serve low-income households, credit unions will think it is not something that they *want* to do and thereby do less than if they were to come to it voluntarily. Projects like Filene’s and Ford’s make the learning process exciting, tap into credit unions’ traditional values, and build a business case for serving low-income populations, while simultaneously buffering some of the risk through experimentation as a group.

D. *Mandates are Politically Impossible: Better Some Change Than No Change*

More cynical proponents of a voluntary approach come to it from a different angle: a stick approach yields better results, but is politically infeasible due to the lobbying power of the trade associations and the close ties between the regulators and the industry. These critics point to previously unsuccessful regulatory attempts to require credit unions to describe their

efforts to serve low-income households within their fields of membership. The industry successfully fought this and similar accountability mechanisms. (Refer to Section I for more details on the political history surrounding earlier “stick” attempts.) Thus, these critics contend that the smaller payoff of a voluntary approach may be better than unsuccessfully lobbying for a stick approach. Some voluntary improvement is better than no improvement.

E. New Regulatory Requirements for Credit Unions Would Prevent Them from Extending into Low-Income Markets

Opponents of new regulatory requirements for community credit unions and credit unions with underserved areas argue that increased reporting mandates on outreach and service to low-income households would deter credit unions from applying for community-charters or adding under-served areas to their fields of membership in the future. As one leader put it, “Ok, I won’t take in an underserved area or convert to a community charter if I have to collect data or be held to some standard.” If that happens, the argument continues, fewer low-income households would have the ability to join credit unions.

F. CRA is not the Answer for Banks

Some argue that CRA has not necessarily been the most effective means for motivating banks to serve low-income communities because, they say, banks only do the minimum necessary to comply and receive sufficient credit for regulatory approvals. Banks can also receive CRA credit without necessarily providing additional *financial* services to a community. These critics argue that CRA over the years has become as much of a bank donation policy to non-profit organizations, as it is a lending policy to low-income households. The standard for getting a satisfactory or above rating is too lenient, and too much of the CRA examination evaluates the amount of outreach *effort*, as opposed to the level of *outcome* resulting from that effort.

Supporters of CRA counter that 1) while some banks may only do the minimum to comply with CRA obligations, studies demonstrate that enough banks do more than the minimum so that the banking industry as a whole out-performs credit unions in serving low- and moderate- income borrowers and 2) the lending test on the CRA examination is now outcome-based.

G. CRA Needs to Be Reconfigured to Work for Credit Unions

Even if CRA is effective at motivating banks to serve low-income households, others contend that it would need to be considerably reconfigured to apply effectively to credit unions. First, while the CRA service test does include an examination of the number of bank services and bank branches offered to low- and moderate-income borrowers, the service test only applies to banks with assets equal to or over \$1 billion; yet, 98% of credit unions have assets under \$1 billion.⁴² CRA *primarily* regulates housing lending practices, not transactional services. At the same time, reasonably priced transactional services and savings/credit building programs are more relevant to low-income households who may not yet be ready for home purchasing.

Second, critics of CRA also point out that many mainstream credit unions primarily provide transactional services and consumer lending. CRA does not *require* banks to collect income-related data on either transactional services or consumer loans. Consumer lending is only examined at the bank’s option, not mandated. In addition, larger credit unions—which tend to

⁴² Prior to September, 2005, the service test was applied to banks with assets between \$250 million to \$1 billion. There is now a community development test for banks of this size, which is suppose to incorporate many of the previous service test elements.

be the ones that have the capacity to provide home loans—are already required to report income-related data on home lending under the Home Mortgage Disclosure Act. (HMDA reporting is required for financial institutions with over \$34 million of assets as of the end of 2004.)

Third, critics of CRA contend, there may not be sufficient regulatory “trigger points” for CRA to catalyze industry-wide change for credit unions. Regulators review banks’ CRA ratings primarily when considering regulatory approval of mergers and acquisitions, which is a frequent request for the banking industry. Credit unions, however, do not often seek changes to their charter. Thus, the concern here is that applying CRA, as is, will not necessarily work as effectively for credit unions as it does for banks.

Finally, the credit union industry argues that CRA was enacted to redress redlining in the banking industry. They argue that credit unions, unlike banks, are not guilty of redlining; therefore, they should not be subject to its antidote: CRA. (It is worth noting that the credit union industry is very sensitive to being subject to CRA.)

In response, supporters of CRA argue that different types of CRA exams apply to different kinds of banks (e.g. small banks, large banks, limited lenders.) Similarly, the CRA exam can be tailored to properly regulate both the service and lending performance of credit unions. It is a misperception, they say, that CRA only regulates lending practices. Furthermore, even if there are not as many “regulatory triggers” for credit unions as there are for banks, supporters argue that just having a publicly available examination has been found to improve lending performance to low- and moderate-income borrowers, and they point to studies which demonstrate that just lengthening the frequency of the CRA exam cycle actually lowers the percentage of loans to low- and moderate-income people.

II. Arguments Against a “Carrot” Approach / In favor of a “Stick” Approach

A. *CRA has a Proven Track Record*

Proponents of applying CRA to credit unions point to studies which document the benefits of CRA in increased lending to low and moderate-income people, the profitability of those loans and the reduction in subprime lending disparities. A Congressionally-mandated study by the Department of Treasury found that controlling for other factors, CRA has a positive and statistically significant impact on banks’ home purchase lending to low- and moderate-income individuals: “institutions covered by the CRA have increased their CRA [home mortgage] lending at a faster pace than those not covered by the Act,” according to the Department of Treasury study.⁴³ A study by the Joint Center for Housing Studies at Harvard came to that same conclusion.⁴⁴ And, as mentioned earlier, the National Community Reinvestment Coalition found that state-chartered credit unions subject to Massachusetts’ CRA law outperformed federally-chartered credit unions not subject to CRA in home purchase, home improvement, and refinance lending. Analyzing national HMDA data over a three year period, NCRC also concluded that banks outperformed credit unions in home purchase lending, refinance, and home improvement lending in 36 states.⁴⁵ (See Appendix B for a review of the literature on credit unions’ service to low-income households.)

⁴³ “The Community Reinvestment Act After Financial Modernization: A Final Report, January 2001, Prepared for the Department of Treasury, www.treas.gov/press/releases/report3067.htm

⁴⁴ Joint Center for Housing Studies, Harvard University, 2002

⁴⁵ “Credit Unions: True to their Mission?” National Community Reinvestment Coalition, 2005



B. ‘Been There, Done That:’ Voluntary Approaches Inspired a Few But Not the Many

Other leaders in favor of a stick approach say that the credit union industry already tried a voluntary approach through initiatives like Project Differentiation and it did not work in spurring industry-wide change. (Project Differentiation was a voluntary effort by the Credit Union National Association to ask credit unions to state and document how they are different from banks, but participation was very low.) While voluntary efforts have inspired or may inspire a few credit unions to increase their efforts and outcomes, according to this line of reasoning, they did not and will not catalyze industry-wide change in serving low-income households. Voluntary efforts often result in the majority of credit unions “free riding” off the few which make a concerted effort with considerable results.⁴⁶ Proponents of the stick approach point to studies demonstrating that credit unions serve fewer low-income households than banks or than higher-income households. (Refer to Appendix B for a review of these studies.)

C. Banks Only Changed When Forced

In looking at the history of financial services to low-income communities, some argue that banks did not meet the credit needs of the communities in which they were located until they were federally mandated to do so by the Community Reinvestment Act. Neither will credit unions. It is only as a result of CRA that banks now outperform credit unions in lending to low and moderate income communities, according to these critics.

D. Community Credit Unions Should Be Required to Serve All Members of the Community / Unfair Competitive Advantage

According to CRA advocates and the banking industry, if granted a “community” charter, credit unions, like banks, should be *required* to serve *all* members of that community—and not “cherry pick” higher income households. Now that credit unions are allowed to serve larger and larger geographic areas and offer similar products as banks, they should be subject to the same community lending requirements. Not doing so is wrong and results in an unfair competitive advantage for credit unions, which are neither taxed, nor subject to CRA.⁴⁷

⁴⁶ Caskey & Humphrey make this point in “Credit Unions and Asset Accumulation by Lower-Income Households,” Filene Research Institute, 1999

⁴⁷ Note: the dividends of credit union members are taxed.

Section V

Summary of the Analysis of the Strategies

ARGUMENTS IN FAVOR OF A “CARROT” APPROACH / AGAINST A “STICK” APPROACH

- Credit Unions Already Serve Low-Income Households
- What’s Needed is Help, Not Mandates
- Voluntary Action Yields Better Results
- Mandates are Politically Impossible: Better Some Change Than No Change
- New Regulatory Requirements for Credit Unions Would Prevent Them from Extending into Low-Income Markets
- CRA is not the Answer for Banks
- CRA Needs to Be Reconfigured to Work for Credit Unions

ARGUMENTS AGAINST A “CARROT” APPROACH / IN FAVOR OF A “STICK” APPROACH

- CRA has a Proven Track Record
- ‘Been There, Done That.’ Voluntary Approaches Inspired a Few But Not the Many
- Banks Only Changed When Forced
- Community Credit Unions Should Be Required to Serve All Members of the Community / Unfair Competitive Advantage



Section Six

STRATEGIES & RECOMMENDATIONS

for Foundations

Given the complexity of the problems, what specifically can foundations do to further the goal of motivating credit unions to better serve low-income households? Bringing together the major themes of the report, this section links the challenges identified by the leaders with the strategies suggested to tackle those challenges. First, we present the range of possible strategies that foundations can pursue, issue by issue. Second, among the range of possible strategies, we provide NEDLC's recommendations to the philanthropic community, time sequenced. We conclude with a table summarizing the report.

Challenge #1: Standards & Data Collection



Convene industry leaders to discuss data collection and industry standards of service to low-income households, including:⁴⁸

- How is “low-income” defined?
- What are reasonable and effective standards on which to measure credit unions’ performance in serving low-income households and in what time frame?
- What kind of data should be collected?
- How should the data be collected?
- Should the collection of data and implementation of standards apply to all credit unions? If not, how should requirements be differentiated by field of membership and/or by asset size?



Fund, or support public policies to fund, a **“Good Seal” of approval program** for credit unions which **exceed the new industry service standard** as demonstrated through data collection.



Provide **financial rewards and/or other public recognition** for high-performing credit unions.



Support regulatory and/or legislative initiatives to **streamline regulatory approval processes** and requirements for **credit unions which provide data and meet the standard.**

⁴⁸ Carrot approaches are symbolized by:  and stick approaches are symbolized by: .



Support **current initiatives to federally mandate the collection of data** and a requirement to meet a **standard** of service by a prescribed date.



CRA Options:

Either foundations can fund further **research on how to affectively adapt CRA to credit unions**. Research topics would include:

- Mechanisms to better regulate transactional services and consumer lending
- Appropriate customization of CRA examinations by credit unions' asset size and/or field of membership
- Analysis of regulatory “trigger points” for CRA

Or foundations can support initiatives to **apply CRA to credit unions without further study**.



Support policy change to **add a service test** to the CAMEL federal **safety and soundness examination**.





Support initiatives to **tie a credit union's tax exemption to its standard of service to low-income households**.

Challenge #2: Lack of Industry Knowledge & Some Misperceptions & Challenge #3: Lack of Industry Focus

There is some disagreement in the field as to whether the existing, industry-connected intermediaries and associations can most affectively implement field-building activities given their broader mandates, competing interests, and capacity constraints.

Therefore, a two-tiered approach to field-building may be appropriate:

1.  **Convene industry leaders to discuss** the need and desirability of forming a new, independent intermediary or association of different-sized credit unions specifically focused on helping credit unions which are interested in serving low-income households.
2.  **And/or support existing intermediaries** (credit union leagues, foundations, applied research institutes, etc.) in current and future **field building initiatives**.



These initiatives should help:

- Demonstrate that serving low-income households can be profitable, and thus have no regulatory repercussions
- Develop, pilot, replicate, and market successful products and services
- Provide in-depth technical assistance and business planning assistance
- Create collaborations among and between mainstream credit unions, community development credit unions, community-based organizations, and public institutions
- Promote peer learning opportunities and disseminate best practices



Initiatives to **tie a credit union's tax exemption to its standard of service** to low-income households, as mentioned under Standards and Data Collection, would also help focus the industry on serving low-income households.

Challenge #4: Regulatory Concerns

Regulatory reforms can be categorized as follows:

- Greater leniency on examinations
- Lifting restrictions on non-member services, usury limits, reserve requirements, and small business lending
- Lifting restrictions on the receipt of outside revenue, such as non-member deposits, grants, and secondary capital.

Foundations can either support policies for these regulatory reforms or support further research on the implications of regulatory reforms.

Further Study of Reform



Fund further **research on the implications of regulatory reforms**.

Research topics would include:

- Impact on safety and soundness
- Which changes would be most effective
- Benefits versus harmful consequences of raising usury limits

Reform Without Further Study



Support policies and internal trainings to provide **some leniency on regulatory examinations** for financially solvent credit unions which take a short-term financial loss while reaching out and serving low-income populations.





Support policies to provide some **regulatory relief on restrictions** on non-member services, usury limits, reserve requirements, and small business lending



Support policies to **allow mainstream credit unions** which serve low-income households to **receive outside revenue**, such as non-member deposits, grants, and secondary capital.

Challenge #5: Financial Concerns



Fund or support policies to offset the costs of expanding service to low-income households, through two strategies:

- Reward credit unions which excel in providing services to low-income households
- Change regulations to enable mainstream credit unions to receive outside revenue, as mentioned above.



RECOMMENDATIONS

NEDLC strongly supports the need for clearly-defined and clearly-articulated effort-and outcome-based standards on which to evaluate credit unions' service to low-income households.

NEDLC also strongly supports the need for more data by which to measure credit unions' efforts and outcomes in meeting that standard.

Since current regulatory initiatives are already underway to collect income-related data and since the authority to expand into larger geographic and underserved areas is relatively recent, NEDLC recommends that the philanthropic community support a carrot approach, but quickly move to support a stick approach if improvement is not made within the next few years.

In response to the recent Congressional hearings on the tax exempt status of credit unions, NCUA's Working Group is said to complete its study on transparency, definition of modest means, and the data gathering process within the first half of 2006. In February of 2006, the NCUA announced that it is collecting data on the income distribution of credit union membership, the extent and type of services provided to members, and credit unions' senior management compensation and benefits. It will gather this information through site examinations of 481 randomly selected federal credit unions. With these new documentation requirements (and hopefully some standards) in place, NEDLC recommends that the industry have the opportunity to demonstrate—more concretely—that it is fulfilling its historic mission to serve people of modest means. If, within a few years, the data demonstrates that credit unions are not meeting a newly-defined standard, we recommend stronger enforcement mechanisms (e.g. CRA, linking tax exemption to a standard of service, etc.)

Our recommendations, listed on the following page, are thus divided by type of strategy and implementation time-frame.

The types of strategies include:

1. **Developing Industry Standards**
2. **Building Intermediaries**
3. **Fostering Further Research, and**
4. **Supporting Legislative and Regulatory Reforms.**

The implementation time-frame includes:

1. *Immediate Actions* needed to influence the outcomes of NCUA's Working Group;
2. *Short-Term Actions* which should be implemented regardless of NCUA's work;
3. *Long-Term Actions* which are only necessary if:
 - a) NCUA does not implement standards and data collection in 2006; or
 - b) NCUA's actions are insufficient; or
 - c) Credit unions do not meet a new Standard of Service.



I. Developing Industry Standards

Immediate Actions

1. **Convene industry leaders** to discuss data collection and industry standards of service to low-income households, including:
 - How is “low-income” defined?
 - What are reasonable and effective standards on which to measure credit unions’ performance in serving low-income households and in what time frame?
 - What kind of data should be collected?
 - How should the data be collected?
 - Should the collection of data and implementation of standards apply to all credit unions? If not, how should requirements be differentiated by field of membership and/or asset size?

Implementation of this Strategy

- The convening should be held in 2006 in order to inform NCUA’s Working Group on service to people of modest means.
- To add credibility and help depoliticize the discussion, the convening should be organized and housed by an entity not connected to the industry.

II. Building Intermediaries

Short-Term Actions

To assess the intermediary field, we recommend a two-tiered approach to field-building:

2. **Convene industry leaders to discuss** the need and desirability of forming a **new, independent intermediary or association** of different-sized credit unions specifically focused on helping credit unions interested in serving low-income households. The discussion should include the role of a new intermediary vis-à-vis the industry-connected intermediaries.

Implementation of this Strategy

- To help depoliticize the discussion, the convening should be organized and housed by an entity not connected to the industry.
3. **And/or support existing intermediaries** in current and future **field building initiatives**.



III. Research

Short-Term Actions

4. Since NEDLC believes that CRA needs modification before it can be most effectively applied to credit unions, NEDLC recommends that foundations **fund further research on how to adapt CRA to credit unions.** .
5. In order to understand the full range of consequences, foundations should **fund further research on the implications of lifting regulatory restrictions** on non-member services, usury limits, reserve requirements, small business lending, and the receipt of outside revenue (e.g. non-member deposits, grants and secondary capital.)

IV. Legislative & Regulatory Reforms

Immediate Actions

6. **Support current initiatives to federally mandate the collection of data** and a requirement to meet a standard of service by a prescribed date.
7. **Support policies and internal trainings to provide some leniency on regulatory examinations** for financially solvent credit unions which take a short-term financial loss while reaching out and serving low-income populations. No further study of this immediate action would be required.

Short-Term Actions

8. Fund, or support public policies to fund, a **“Good Seal” of approval program** for credit unions which **exceed the new industry service standard** as demonstrated through data collection.
9. **Provide financial rewards and/or other public recognition** for high-performing credit unions.
10. Fund or support **policies to offset the costs** of expanding service to low-income households.



Long-Term Actions: If NCUA Standards are not Mandated or Met

11. Support a strategy for legislative change to **apply an adapted CRA** to credit unions
12. Support a strategy for legislative change around **mandated data collection and standards.**
13. Support policy change to **add a service test** to the CAMEL federal **safety and soundness examination.**
14. Support initiatives to **tie a credit union’s tax exemption to its standard of service** to low-income households.



Section VI

Report Summary: Challenges, Strategies, & Recommendations

Challenges	Strategies		NEDLC's Recommendations to Foundations
	Carrots 	Sticks 	
Lack of Data on Effort or Outcome in Serving Low-income households	<ul style="list-style-type: none"> Convene industry leaders to discuss data collection and industry standards of service to low-income households Promote a “Good Seal” of approval program to award credit unions which meet a standard Streamline regulatory approval processes & requirements for credit unions which provide data and meet a standard Provide financial rewards to credit unions which supply data & meet the standard 	<ul style="list-style-type: none"> Federal mandate to collect data & meet a standard of service Apply CRA to credit unions now, OR Study how to adapt CRA to credit unions in the future Add a Service Test to the CAMEL safety and soundness exam Tie tax exemption to a Standard of Service 	<p><u>Developing Industry Standards: Immediate Actions</u></p> <ul style="list-style-type: none"> Convene industry leaders to discuss data collection and industry standards <p><u>Building Intermediaries: Short-Term Actions</u></p> <ul style="list-style-type: none"> Convene industry leaders to discuss the need for a new association Fund intermediary field building initiatives <p><u>Research: Short-Term Actions</u></p> <ul style="list-style-type: none"> Fund research on how to affectively adapt CRA for credit unions Fund research on the implications of lifting regulatory restrictions <p><u>Legislative & Regulatory Reforms</u> <i>Immediate Actions</i></p> <ul style="list-style-type: none"> Support current initiatives to mandate data collection and standards Support policies and trainings to provide some leniency on regulatory examinations <p><i>Short-Term Actions</i></p> <ul style="list-style-type: none"> Fund or promote policies to fund a “Good Seal” of approval program for high-performing credit unions Provide financial rewards and/or other public recognition for high-performing credit unions Fund or support policies to offset the costs of expanding service to low-income households. <p><i>Long-Term Actions: If NCUA Standards are not Mandated or Met</i> Support strategies for the following policy reforms:</p> <ul style="list-style-type: none"> Apply an adapted CRA to credit unions Enact mandated data collection and standards Add a Service Test to the CAMEL regulatory exam Tie tax exemption to a Standard of Service
Lack of Standards on Effort or Outcome			
Lack of Knowledge, Misperceptions of Risk	<ul style="list-style-type: none"> Build & educate the Field through intermediaries 		
Lack of Industry Focus	<ul style="list-style-type: none"> Form a new association of credit unions specifically interested in serving low-income households 	<ul style="list-style-type: none"> Tie tax exemption to a standard of service 	
Regulatory Concerns	<ul style="list-style-type: none"> Provide relief on regulatory restrictions Provide leniency on regulatory exams Or research implications of these regulatory changes 		
Financial Concerns	<ul style="list-style-type: none"> Reward good behavior financially Change regulations to allow outside sources of revenue 		



Appendix A

INTERVIEW LIST

Credit Union National Association

- Bill Hampel, Senior Economist

Filene Research Institute

- Bob Hoel, Executive Director
- Mark Meyer, Director of Innovation
- Lois Kitsch, Director of Field Projects

Consultants to the Field

- John Caskey, Professor of Economics, Swarthmore College
- Patricia Sterner, JFB & Associates, LLC
- John Weiser, Brody, Weiser, Burns (provides consulting services to the National Credit Union Foundation)

National Community Reinvestment Coalition

- John Taylor, President
- Joshua Silver, Vice President of Research & Policy
- Noelle Melton, Research & Policy Analyst

National Credit Union Administration

- Norman D'Amours, former Chairman of the Board
- Deborah Matz, former Board Member
- Dennis Dollar, former Chairman of the Board

National Credit Union Foundation (NCUF)

- Stephen Delfin, Executive Director
- Steve Bosack, Deputy Director

National Federation of Community Development Credit Unions

- Cliff Rosenthal, Executive Director

Woodstock Institute

- Marva Williams, Senior Vice President

Credit Unions

- Mike Vadala, President & CEO, Summit Federal Credit Union
- William Myers, CEO, Alternatives Federal Credit Union (& manages the Community Development Banking list-serve)
- Jim Blaine, CEO, State Employees' Credit Union (NC)
- Ed Gallagly, President/CEO, Florida Central Credit Union
- Kirk Kordeleski, President/CEO, Bethpage Federal Credit Union (NY)



Credit Union Leagues

- Lucy Ito, Rita Fillingane, and Letty Cordon-Hernandez, staff, California Credit Union League
- Nancy Dotson, Foundation Services Manager, Richard Myles Johnson Foundation (affiliated with the California Credit Union League) Foundation
- Dan Egan, President, Massachusetts Credit Union League
- Jim Drogue, VP League Operations, Wisconsin Credit Union League



Appendix B

LITERATURE REVIEW

I. The ‘To What Extent?’ Question: Credit Unions Service to Low-income households Quantitative reports

Below is a review of quantitative studies that measure the extent to which credit unions serve low-income households, divided into two categories: reports which indicate credit unions serve more low-income households than banks and reports which show credit unions serve fewer low-income households than banks serve low-income households or than credit unions serve higher-income households. With the exception of the GAO report and the Woodstock Institute reports, these studies were conducted by organizations supported by the credit union industry or consumer advocates.⁴⁹

A. Credit Unions Serve Fewer Low-Income Households than Banks or than Higher-Income Households

1. “*Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management*,” **Government Accountability Office**, 2003

Approach: Analysis of 2001 Survey of Consumer Finances (SCF), Federal Reserve Board, 2001 HMDA data, and a review of other studies; used CRA definitions of low, moderate, middle and upper income

Conclusions

- Not enough data on the income characteristics of credit union members.
- Using Federal Reserve Board data, the GAO found that 36% of households that only or primarily used credit unions had low or moderate income, compared to 42% of households that used only banks.
- A greater percentage of households that only used credit unions were middle- and upper-middle income (19% and 22%), compared to those that only used banks (16% and 17%.)
- Percentage of households that only used credit unions in the low-income category was lower than the percentage of households in the low-income category that used banks (16% versus 22%.)
- This difference may be due to the fact that credit union membership has traditionally been tied to occupational fields of membership.

⁴⁹ The summaries only highlight portions of these reports which address the “To What Extent?” question.



2. *“Rhetoric or Reality: An Analysis of Mainstream Credit Unions’ Record of Serving Low-income households,”* Jacob, Bush, Immergluck, February, 2002
Funded by: Woodstock Institute

Approach: analysis of 2001 Metro Survey, a household survey of roughly 3,000 respondents in the six-county Chicago region

Conclusions:

- Credit unions in the six-county Chicago region serve much lower percentages of lower-income households than they do middle- and upper-income households.
 - While 40% of households with income between \$60,000 and \$70,000 held credit union membership, only 23% of households earning \$30,000-\$40,000 held credit union membership.
 - Only 12% of families earning between \$10,000 and \$20,000 held credit union membership.
3. *“Credit Unions: True to their Mission?”* **National Community Reinvestment Coalition**, 2005

Approach: 1) using CRA software, analyzed HMDA data on home purchase lending and single-family lending between 2001 and 2003; 2) compared state-chartered credit unions in Massachusetts, which are subject to CRA, and federally-chartered credit unions in Massachusetts, which are not subject to CRA. Performance was measured on 14 indicators, divided into portfolio share indicators (or a lender’s loan percentage to a specific group) and denial-disparity indicators (or the rate of denial to one group)

Conclusions

- Between 2001 and 2003, banks nationwide outperformed credit unions in 37 out of 42 indicators of single family lending.
 - Credit unions performed best in 2003, where they outperformed banks in 5 of 14 indicators, whereas in 2001 and 2002 banks outperformed credit unions in all 28 possible indicators. Banks demonstrated the largest advantage (by 2.5%) in “percent of loans to LMI and/or minority census tracts” in 2001.
 - Combining home purchase, refinance, and home improvement lending, banks outperformed credit unions in 36 states in the three-year period between 2001 and 2003.
 - State chartered credit unions subject to CRA outperformed federally-chartered credit unions 69% of the time in home purchase, home improvement and home refinance lending combined.
4. *“Analysis of National Lending Trends of Credit Unions and CRA-Covered Lending Institutions,”* **National Community Reinvestment Coalition**, 2002

Approach: an analysis of home lending HMDA data in 1999 and 2000 between federal credit unions, lending institutions covered by CRA, and all lenders reporting HMDA data.

Conclusions

- CRA-covered lenders and all lenders outperformed federally-chartered credit unions in home purchase loans to minority and low- and moderate-income (LMI) borrowers.
- From 1999-2000, CRA-covered lenders increased their loans in LMI tracks by 14.2% while NCUA-covered lenders increased their lending in LMI tracks by 6.4%.

B. Credit Unions Serve More Low-Income Households than Banks

1. “*Who Uses Credit Unions?*” Third Edition, Lee and Kelly, 2004;

Funded by: **Filene Research Institute**

Approach: analysis of 2003 Survey of Consumer Finances (SCF), Federal Reserve Board; in-home survey of 4,449 households

Conclusions

- Households using only a bank have higher median incomes and wealth than households using only a credit union.
 - Among households with incomes under \$20,000, more than three out of five use a bank only.
 - Households using both a bank and credit union have higher median income and wealth than households using only a credit union or only a bank.
 - Among those households using both a bank and a credit union, those that use primarily a credit union have lower median incomes than those that use primarily a bank.
2. “*Serving Members of Modest Means*,” Market Research & Information, **CUNA & Affiliates**, 2003
- *Approach:* a survey conducted between September 2002 and January 2003 to measure credit unions’ involvement in serving the financial needs of members and potential members of modest means, defined as those with household incomes under \$40,000. Sample survey was sent to 2,548 credit unions, 256 of which had added an underserved area and are referred to in the study as “expansion credit unions.” 1,100 credit unions, or 43% of the sample size, responded and 93 of those added an underserved area.
 - *Outcome-based measurement:* while the survey tried to answer outcome-based questions regarding the income distribution of credit unions current and potential membership, as many as one-third of the respondents did not have the data and/or were not even comfortable making an estimate.
 - *Thus, the survey mostly quantifies effort-based approaches.*



Conclusions:

- Roughly 50%-75% of credit unions with assets of \$20 million or more and expansion credit unions offer programs geared toward low- and moderate-income members (e.g. check-cashing services for members, money orders, financial/debt counseling, and risk-based lending.)
- Roughly 15% of all credit unions surveyed and 40% of expansion credit unions also offer special home mortgage products, financial education seminars, and partnerships with community-based organizations.
- One-third of the credit unions surveyed provide a loan or a share certificate account for \$100 or less.
- Expansion credit unions make particular efforts to attract low- and moderate-income people through newspaper ads and participation in community events. Expansion credit unions are better able to attract low-income households in the underserved areas than higher income people.
- Within the previous three years, 27% of the credit unions surveyed (and over half of the expansion credit unions) provided technical support/staff, training, equipment, financial and or other assistance to credit unions which serve mostly low- and moderate-income households.
- Aggressive SEG and residential expansion efforts over the past few years have led to shrinking member-to-potential member rates.

II. The ‘How to?’ Question: Best Practices in Serving Low-income households
Qualitative reports

Below are short descriptions of qualitative reports, mostly written or funded by industry trade associations and foundations, which profile best practices of a handful of individual credit unions in reaching out and serving low-income households. Common strategies among the different credit unions depicted in these reports include:

- innovative branching in low-income areas;
- customized product development (e.g. short-term loan products, IDAs, reverse credit building loans, etc.);
- financial education; and
- special outreach to immigrant communities (e.g. branching in an immigrant community; hiring bilingual/bicultural staff; accepting matricular consular identification, bilingual call centers and marketing materials.)

The reports also describe different models to implement these strategies, including:

- Partnering with community-based organizations and local leaders
- Partnering with community development credit unions and public agencies, and/or
- Partnering with check cashing outlets and community-based organizations
- Incubating a new community development credit union; and lastly



- Sharing branches with other credit unions through Credit Union Service Organization (or CUSO) in an effort to divide the costs and spread the risk. A CUSO leases office space, hires staff and arranges network software to enable staff at the shared branch to obtain members' account data from participating credit unions and to post transactions.

1. *“Credit Unions and Asset Accumulation by Lower-Income Households,”* Caskey & Humphrey, 1999, sponsored by **Filene Research Institute**
Funded by: National Credit Union Foundation, under a grant by the Ford Foundation

Intended to serve as a resource for other credit unions, this report profiles the effort of fourteen mostly mainstream credit unions to reach lower-income households, categorizing the strategies by: putting branches in low-income areas, developing specializing products for low-income households, and providing education or counseling services. It discusses the strengths and challenges of each approach and suggests that the majority of mainstream credit unions do not make much effort to reach low-income households. The study concludes by: offering strategies to help other credit unions reach more low- and moderate-income people, recommendations for customized products and services to meet the financial needs of low- and moderate-income households, and means to off-set the financial costs of these initiatives.

2. *“How Mainstream Credit Unions Can Effectively Serve Disadvantaged Communities,”* Jerry Black, Aspen Institute
Funded by: The Ford Foundation

This report profiles a few exemplary credit unions' efforts to improve the infrastructure for delivering financial services to low-income households, categorizing the approaches by three different implementation models:

- 1) *Mainstream credit unions working alone* (e.g. a large credit union opens a branch in a low-income area which already has a market presence in the area and/or existing members living in the area)
- 2) *Partnerships between mainstream credit unions and community based organizations* (e.g. a smaller credit union with financial and infrastructure constraints is able to leverage the resources of a trusted organization in the community that has relevant cultural and linguistic capacity); and
- 3) *Partnerships between mainstream credit unions and community development credit unions* (e.g. a large credit union builds the infrastructure of a smaller credit union, already connected to the community, so that the smaller credit union can serve more people.)

The study identifies three “success” factors common to each of the models including:

- 1) Serious investment in meeting the social mission among the credit union leaders
- 2) Keen understanding of member's financial lives in order to develop and market the appropriate mix of products and services
- 3) Effective infrastructure in order to offer high-touch services in a cost-effective manner.

3. *“Making a Difference, Credit Unions Reaching out to Members of Modest Means,”* **Credit Union Executive Society (CUES)**

Funded by: The Ford Foundation

This report profiles five mainstream credit unions’ best practices in reaching and serving low-income households and categorizes each by their strategy:

- 1) Minority/immigrant outreach (e.g. added an under-served community to its field of membership, and opened a branch there with bilingual staff and marketing materials)
- 2) Multiple partnerships (e.g. added an under-served area; partnered with a coalition of churches and community-based organizations and a check-cashing outlet to offer non-cash services in the under-served area at a check-cashing outlet, where a community-based organization recruits for participants in financial education)
- 3) CUSO Model (e.g. to share the costs and spread the risks, 13 credit unions created a CUSO in El Paso, Texas which helps low-income households purchase homes by offering financial education and home buyer’s counseling in Spanish and specialized mortgage loan products)
- 4) Mainstream/community development credit union partnership (e.g. mainstream credit union helps start a CDCU)
- 5) Social entrepreneurship (e.g. Canadian credit union links serving an underserved community to environmentally friendly policies and ethical decision-making)

The report also identifies the following seven common elements of success to these efforts:

- 1) Know the population you wish to serve
- 2) Seek out effective partners
- 3) Be patient
- 4) Demonstrate commitment from the top down
- 5) Establish a physical location
- 6) Tailor products and services to meet the needs of the population you wish to serve
- 7) Strike a balance between the needs of the underserved population and the needs of the credit union

4. *“Financial Services for People of Modest Means: Lessons from Low-Income Credit Unions,”* Marva Williams, **Woodstock Institute**, March 2004

Funded by: the Ford Foundation & the MacArthur Foundation

This study profiles three low-income credit unions in order to inform mainstream credit unions on how to reach out and serve lower-income households and communities. The following six strategies are recommended:

- 1) *Financial Education & Counseling* to further asset development
- 2) *Partnerships* with other financial institutions, credit union associations, community or consumer groups, and local businesses to subsidize costs, increase revenue, and develop specialized products and services
- 3) *Financial Support* from public agencies and intermediaries



- 4) *Sustainability* by cross selling products, adjusting loan underwriting procedures, encouraging members' use of automation, and seeking businesses to underwriting special loans for their employees
 - 5) *Know Your Customer* and adapt lending products and financial services accordingly
 - 6) *Marketing* at community events
5. *“Check-Cashing and Savings Programs for Low-Income Households: An Action Plan for Credit Unions,”* John Caskey

Funded by: **Filene Research Institute** and the Center for Credit Union Research

This guide provides business strategies (including financial projections) which show how credit unions and CUSOs can provide products and financial services similar to those of the alternative financial sector but at lower fees—and still generate income. It explains:

- the disadvantages of the alternative financial sector;
- why customers use alternative financial services anyway;
- how credit unions can add check cashing and bill paying services to their mix of products and increase their profitability; and
- how credit unions can lend prudently to alternative financial services customers with flawed credit reports and help those with seriously flawed credit reports repair their credit over time.

The report discusses financial considerations in maintaining a branch that serves mostly low-income households and presents strategies to cut costs by either opening a shared branch (CUSO,) or partnering with a community-based organization. It then outlines a strategy for serving the underserved which includes:

- how to reach low-income households
- payment services for households without month-to-month savings
- deposit accounts and savings building products
- credit services, and
- financial literacy education.

6. *“Building Community Assets: A Guide to Credit Union Partnerships,”* Williams & McLenighan, October 2004, **Woodstock Institute**

Funded by: Annie E. Casey Foundation and the Ford Foundation

Unlike the previous reports, this guide is written to help community organizations develop partnerships with mainstream credit unions (as opposed to the other way around.) It begins with explaining why community organizations should consider partnering with credit unions and moves to outline the following seven specific steps to forming a credit union partnership:

1. Determine Your Community Needs
2. Identify Potential Credit Union Partners
3. Do Your Homework
4. Prepare a Preliminary Proposal
5. Make Contact
6. Negotiate an Agreement
7. Implement, Monitor, and Evaluate the Partnership

