

In the Future No Credit Unions

by Dan Clark

What might be said about our movement with the clarity of retrospect a century from now? Here's an excerpt from *Money And Banking in America*, a college text published in 2115 by Global Education, Chapter 5, "Credit Unions³/₄The Camelot Of Consumer Finance."

Credit unions emerged in Europe in the middle of the 19th Century, appearing on the American landscape as early as 1909. The Federal Credit Union Act and many state laws emerged in the mid-1930s. Credit unions flourished in America until the turn of the century, and died out in the first quarter of the 21st Century. The conditions that gave rise to credit unions ceased to exist in a way the credit unions could exploit and it became their epitaph.

Banks in Europe could not afford or would not reach out to provide their services beyond the populous cities. Rural residents and farmers needed access to credit and a safe place to save. In the absence of bank facilities, several experiments materialized. The Raiffeisen Societies of Germany came to the attention of a Boston, Massachusetts businessman, Edward A. Filene.

A prolific writer and student of social and economic systems, Filene introduced the idea of cooperative, democratically controlled financial institutions to America. As a businessman, Filene was not in the mainstream. One of his philosophies was that the first charge against excess profits should be a reduced price to customers. Cooperative credit matched this idea. Filene spent much of his personal wealth establishing the credit union movement.

When the U.S. Congress enacted the Federal Credit Union act in 1934, Filene wasted no time establishing a national trade association to spread credit unions. Filene and his aggressive executive director, Roy F. Bergengren, crisscrossed the country chartering credit unions everywhere. By 1938 state and federal regulators chartered over 6000 credit unions.

Federal and state credit union laws offered three basic chartering options, community, associational and employment charters. The path of least resistance, employment based credit unions dominated the charter types. Governmental agencies, major corporations, and small businesses sponsored credit union charters to serve their employees. Even at the outset, the movement in America differed from Europe's. While Europe's movement was heavily rural and farm oriented, less than five percent of America's credit unions served farmers.

Credit unions in America hit a peak of over 23,000 in 1969. At the beginning of the 21st Century, fewer than 8000 credit unions served a bit more than one in four Americans. While their member numbers and total deposits grew, the decline in the number of credit unions was due to many reasons, principally the growing complexity of products and services, volatile economics, stiff competition, and limiting laws.

Until the 1960s, credit unions did not consider each other as competitors. When an employee left a company they had to close their account at their company's credit union. After regulations changed to allow members to always remain as members, and after regulations changed to allow members of families to join, the growth of dual wage-earner families during the period meant that most households could do business with more than one credit union at a time. Protected member-customer bases eroded. Many credit unions were ill prepared to compete for business.

Employment-based credit unions had a significant advantage over the association and community types because of the ease of payroll deduction that helped credit unions achieve one of their stated missions, the promotion of thrift. It was in the late 20th Century that direct deposit of all employee pay became the norm. Direct deposit eliminated one of the unique convenience features of belonging to a credit union at work.

The emergence of the Internet and the World Wide Web also contributed in a major way to eroding the credit union-at-work advantage. Increasing numbers of consumers could get what they needed from multiple institutions with better prices because of the low overhead advantages of offering services electronically, on-line.

Another stated mission of credit unions was to provide credit at reasonable rates. Almost every one assumed one of the social benefits of credit unions was that they provided services to people who did not have access to banks or could not afford their services. Because credit unions chartered primarily along employment lines, it turned out that most credit union fields of membership, the population the charter defined, were not as low on the economic scale as was widely believed.

Credit unions instituted deposit insurance, called share insurance, about forty years after banks, in 1970. This made credit unions a greater competitor for short-term deposits. Until 1970, credit unions remained very small and, due partly to their relationship with their sponsoring employers, did not perceive a need for deposit insurance.

Until the 1960s credit union laws and regulations limited loan amounts and savings services in significant ways. In the 1970s, credit unions began to provide a wider variety of services, most notably, checking accounts, called share drafts. There were some subtle legal differences between share drafts and checks not discernable to consumers. With checking, credit unions began taking core, low-cost deposits from banks, especially community banks, which had until then owned the checking business they invented in the 19th Century and in the 20th Century made available to consumers.

In the 1970s federal credit unions received the authority to make and hold mortgage loans. Many state laws had always allowed mortgages yet, due to the comparative small size of credit unions until then, few made mortgage loans. About a fourth of all credit unions grew large enough to offer home mortgages for their members. Banks took note of this new form of competition.

Deregulation of financial services occurred in the late 1970s and early 1980s and, as a result, brought non-banks into the banking arena. Brokerage firms and wire houses (e.g. Merrill-Lynch, Chapter 7) began offering money market funds that competed effectively with bank and credit union checking accounts. Ostensibly to meet the demand of the baby boom generation (Americans born 1946 to 1964), other companies began offering credit cards, mortgages and other forms of consumer credit. Competition for a declining loan market sank many credit unions ill equipped for the rigors of the competition.

While banks consolidated apace during the 1980s and 1990s to be more competitive with major global banks from Europe and Japan, credit unions rarely consolidated except to merge a faltering credit union with a healthy one. Credit union regulators and credit union trade associations did not favor the loss of credit unions by number in exchange for economies of scale to be enjoyed by a small number of larger credit unions.

Another deterrent to credit union consolidations had to do with status and incentive. Credit union boards

and management teams hated to give up their credit union's identity and their power. As non-profits, credit union leaders gained nothing personally from mergers in contrast with community bankers, many of whom chartered banks solely to sell out their profitable enterprises to regional or national banks for hefty personal gains. As the banks consolidated, they became stronger over all. In contrast, most credit unions did not enjoy economies of scale and their operating costs continued to rise compared to banks whose profits rose. As a result, in the first decade of the 21st Century, credit union fees and loan rates rose above those of the banks, and their share dividends dropped to below the interest banks paid for deposits.

The cost differences between credit unions and banks might have been a political safety net for credit unions had they exploited the advantage of the cost-disadvantage. The cost differences continued to worsen as the upscale, discerning members looked for better deals at banks and on the Internet. Credit union memberships gradually became downscale consumers requiring more personal assistance, i.e. higher staffing levels. Economists agree that credit unions could have thrived in this niche and continued to enjoy the tax exempt status. However, credit unions took a political position against bank fees and charges. Credit unions took up with consumer groups in the 1990s publicly criticizing banks for profiting on fees, especially ATM surcharges, a charge levied at the machine by the machine owner mostly on non-customers. When interest margins dried up for credit unions they had an uphill public relations battle as they attempted to levy more fees of their own to survive.

At the beginning of the 21st Century, America's economy was awash in consumer-service capacity-there were too many lenders and traditional depository institutions for the number of people needing them.

In the 1990s, bank trade associations, usually waging a quiet war against one another, community banks against the big banks in particular, rallied their energies to remove credit unions from the picture. They did this while simultaneously seeking and acquiring additional powers to protect and expand the markets of the regional, national and global banks, and their profitability. (See "The Big Banks Help the Community Banks: The Fox in the Hen House," Chapter 13.)

As not-for-profit cooperatives, credit unions enjoyed exemption from business income taxes. As disclosed in previous chapters, mutual thrift institutions lost their tax exemptions in 1951. Commercial banks lobbied to no avail remove the tax exemption from credit unions in order to, as they put it, "level the playing field."

The combined banking lobby eventually attacked credit unions on a different front. They won several law suites against individual credit unions and the federal regulator in the 1990s. Banks claimed that credit unions did not have the legal right to serve more than one employer. The federal credit union regulator had allowed multiple employer groups in part to diversify the assets of credit unions in an effort to preserve the integrity of the deposit insurance fund.

In 1998, the U.S. Supreme Court ruled in favor of multiple employer group fields of membership. But the victory was short lived.

The banks shifted again to a direct attack on the tax exemption and won in 2002. They won because: · they provided a unified front; · they made the case that credit unions were not intended to become large and serve global communities and become full-service in full competition with banks. The irony is that credit unions invented consumer-banking services that commercial banks ignored for centuries until the late 1940s, after World War II.

Credit unions lost important judicial and legislative battles to retain their unique non-profit advantages because the movement split. Small credit unions, about two thirds of all U.S. credit unions, did not have the will or resources to stand and fight. Many did not feel the fight was theirs because most of them served a single-employer. Smaller credit unions did not reject and fight against proposals to tax and regulate differently the larger credit unions.

Larger credit unions had been loyal members of their trade associations, even though most of them felt those associations failed to meet most of their needs. They felt their support of the associations provided important services to the smaller ones and, therefore, the credit union movement as a whole. When regulations and taxation changed, the larger credit unions pulled out of the traditional associations causing many of them to collapse and taking hoards of smaller credit unions with them.

Several credit unions converted to other forms of charter, at first to mutual savings banks and then even to commercial banks. Credit union trade associations, further tearing away at the fabric of credit union solidarity, often resisted the early conversions.

While tax rates were not particularly high, credit union boards and managers could not make the transition. They were unable to build risk capital sufficiently to remain safe and sound. More importantly, the loss of the tax exemption demoralized the movement after so many years of heated battles in the courts and the halls of legislatures in most states and in Washington.

The combination of small numbers of credit unions and the trend toward government consolidation forced credit union regulatory bureaus and agencies to merge with the banking regulators. Lacking further differentiation, lawmakers looked upon larger credit unions as an unnecessary form of bank that needed no subsidy via tax exemption. As a result, all preferential laws and regulations disappeared and with them the credit unions, one-by-one.

Credit unions were so busy fighting for their own legislation that they failed to fight against some important banking legislation. As the 20th Century came to a close, banks gained the ability to merge and own insurance companies and brokerage firms, something prohibited since the great depression (See "Global Competition Goals, Over Capacity, and a Healthy Economy Snuff Out Glass-Steagal Fire Wall," in Chapter 6). Perhaps more significantly, they were able to merge or consolidate with non-financial companies. This had two effects. First, as the banks became larger and more diversified, the "uneven playing field" continued to tilt in favor of banks. Second, government guarantees and subsidies meant to protect the financial system, and so key to America's economic success, became indirectly extended to other industries due to their ownership of banks. For example, the Federal Reserve banks provided liquidity to member banks and therefore their parents such as Microsoft (a major software company), Wal-Mart (a major retail consumer goods company), and others (See "U.S. Government Subsidizes Poorly Run Banks and Illiquid Big Business," in Chapter 10).

Credit unions also missed a strategic opportunity known in the 1990s as shared branching. Almost a third of all credit unions had data systems capable of communicating with each other through existing automated teller machine (ATM) networks. (See "Cash Machines Led to Cashless Society," in Chapter 17.) Had all of them connected, their members could have used more facilities across America than any of the top ten U.S. banks' branches. Shared branching held the potential to gain economies of scale without merging credit unions, and while providing unique access to credit union services without having to close and reopen accounts as Americans changed jobs, careers, and locations frequently beginning in the late 20th Century and accelerating to today.

As credit unions disappeared, American consumers were left with no choice but to do business with for-profit banks. Bank consolidations continued apace for the first half of the 21st Century until there were a handful of international banks serving the nation, only two of which were domiciled in America, Chase-Sumitomo and Wells-Deutche.

With credit unions gone, federal "life-line banking" legislation attempted to fill the gap. The legislation required banks to provide low-income consumers with no or low-cost transaction services. Many bankers saw the irony in this and bemoaned the loss of credit unions that use to serve this niche. However, the banks provided virtually no personal financial guidance appropriate to their economic level. A number of credit unions reinvented their operations to provide financial guidance, but it was not widespread enough for credit unions as a whole to prove their value and to maintain their unique advantages.

As is so often to case throughout history, when a company, segment, or industry fails to provide society with real value, it ceases to exist. Credit union people had no control over many of the trends that rendered credit unions archaic: demographic shifts, the strength of bank lobbying efforts, and the advent of electronic commerce. However, if credit unions could have rallied together to seek out and serve predominately low-income consumers with advice and information, and contributed to the limiting of bank powers, the story of 21st Century America would have been very different.

Many economists believe that low-to moderate-income consumers would have had greater financial success if credit unions had remained a viable choice. Without credit unions, many could not use banks and paid a heavy price to obtain fringe-banking services from private businesses including pawn shops, payday lenders, and title loan companies. As a result, the separation the haves and have-nots widened and America's economy suffered greatly. (See "The Widening Economic Abyss, Chapter 21.)

If you were reading the above in the year 2115, what message would you like to send back to credit union leaders in our current time? What leadership role could you and your organization play now to save credit unions and change history?

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Email dan@danclark.com

Web www.danclark.com

Phone 850-878-1239