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A Close Look at Credit Unions

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*In Issues and Interpretations, Dr. Paul Nadler discusses the competitive threats coming from thrift institutions.
The fastest growing competitors are credit unions.*

A Close Look at Credit Unions

*DAVID S. KIDWELL and
RICHARD L. PETERSON**

CREDIT, UNIONS HAVE LONG BEEN IGNORED by, other financial intermediaries because of their relatively small size, both individually and in the aggregate. Since World War II, however, credit unions have been the fastest-growing financial intermediary in the U.S. economy. Having grown at a compounded annual rate' of nearly 16 percent, credit unions are currently the third largest supplier of consumer credit, holding one-sixth of all outstanding consumer credit. In addition, credit unions are taking steps to become more important competitors in other bank markets-as they have recently begun to issue share drafts, which are equivalent to NOW accounts and are now empowered to make mortgage loans.

The apparent rising fortune of credit unions has prompted George Mitchell, a former Governor of the Federal Reserve System, to forecast recently that credit unions-and not savings and loan associations-will be the commercial bank's toughest competitor in the consumer financial market within the next five to ten years.

WHAT CREDIT UNIONS ARE

Credit unions are small, nonprofit consumer-organized savings and lending institutions,, owned entirely by their member-customers. Their stated purpose is to encourage thrift among members, provide a source of consumer credit at a reasonable rate, and provide members an opportunity to use and control their own money in order to improve their economic and social condition. Typically, credit unions are organized by consumers having a "common bond," such as employees of a given firm or members of a union or professional association.

A unique feature of credit unions, not shared by other depository institutions, is their membership requirement. To apply for membership, an individual must provide financial and demographic information about himself, and purchase an initial share in the credit union-generally \$5 to \$10. This entitles him to all financial services offered by the credit union and allows him to vote for election of officials and to participate in the committees formed to run the credit union.

Member deposits or "share accounts" are the primary source of funds for credit unions. Share accounts, are considered part of the credit unions equity. The interest paid on member share (termed "dividends") is not

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guaranteed at a specific interest rate, as is the interest paid on accounts at commercial banks or savings and loan associations, but is declared periodically (usually quarterly) by each credit union's board of directors.

How The Grew

Credit unions originated in Germany in the middle of the nineteenth century. Their original objective was 'to ease the problems of the poor and working classes by enabling them to pool their savings and lend to each other at low interest rates. The early credit union philosophy was closely aligned with humanitarian goals, many being organized through church affiliations. Embodied in the original spirit of early credit union societies was that the group should have a "common bond," giving each member a feeling of responsibility toward the entire group. By the end of the nineteenth century, credit union societies operated throughout most of Europe.

The first credit union in the United States was formed in Manchester, New Hampshire, in 1908. During the early years, the credit unions' growth was confined mostly to Massachusetts and other New England states. The growth of the credit union movement is largely attributed to the work of Edward A. Filene, a Boston merchant who promoted the movement through the Credit Union National Extension Bureau (CUNEB). The bureau was financed by the Twentieth Century Fund, a foundation formed by Filene to improve employer employee relations. By 1934, credit union laws were adopted in thirty-eight states and the District of Columbia, containing over 80 percent of the United States population.

The early credit unions emerged to fill an unmet need in American cities. At that time, there was an absence of legal consumer credit for working people due to unrealistically low usury laws in some states and a lack of interest in the small saver by commercial banks. Because of the strong demand by middle- and lower-income people for a convenient and safe place to borrow and save, some large department stores began to accept and pay interest on customer deposits, and many large businesses performed similar services for their employees. Employers also recognized that the establishment of a convenient banking-type facility would make it easier for workers to conduct their financial affairs, thereby reducing absenteeism. The goals of early American credit union societies were to encourage thrift among their members through education, provide a safe and convenient location to save, offer financial advice and counseling, and extend credit on reasonable terms to their members.

Credit Union Balance Sheet

At year-end 1975, member share accounts provided the major source of funds for credit unions accounting for 86.8 percent of total credit union liabilities. Reserves and undivided earnings provided 7.8 percent, and borrowed funds, 3.2 percent of total liabilities.

Growth of the credit union industry has been extraordinary.

The heavy reliance on a single type of liability as a source of funds does not appear to have hurt the credit unions' ability to attract funds. In the decade ending in 1975, credit union shares grew at an annual compound rate of nearly 14 percent. During the same period, commercial banks' savings deposits rose at an annual rate of 15 percent, while deposits at savings and loan associations and mutual savings banks expanded by 10 and 8 percent, respectively.

The average share account held by all credit unions was slightly over \$1,000 at the end of 1975. This figure is somewhat misleading because, in order to borrow, credit union members must maintain a minimal balance of \$5 to \$10. At the end of 1975, 77 percent of all federal credit unions' share accounts were less than \$1,000,

accounting for, 13 percent of the dollar value of all shares. In contrast, share accounts greater than \$5,000 comprised less than 5 percent of all accounts, but accounted for, almost half (48 percent) of total share capital.

The major assets held by credit unions are member loans, which constituted 74.1 percent of total credit union assets at year-end 1975. In general, these are relatively small short-term consumer loans, used either to purchase durable goods or for personal or family expenses. Credit union investments, which are held to provide a cushion for temporary imbalances of savings inflows and outflows, comprised, 20.3 percent of total assets at year-end 1975. These investments typically consist of U.S. Government obligations, federal agency securities, common trust investments, and savings and loan association shares. Cash and other assets accounted for 5.6 percent of all credit union assets.

Just as credit union savings accounts have grown rapidly, so have credit union consumer installment loans. For the ten-year period ending in 1975, credit unions' installment loans grew at an annual rate of 15 percent. Meanwhile, consumer installment loans of commercial banks and consumer finance companies grew at annual rates of only 11 and 5 percent, respectively. And credit unions have achieved rapid increases in consumer lending even without the convenience of revolving lines of credit cards.

The purpose of credit union loans have remained fairly stable over the years as indicated by periodic samples of federal credit union loans taken by the National Credit Union Administration (NCUA). In the 1975 sample, approximately one-third of credit union loans were for the purchase of new and used automobiles. Loans for other durable goods such as boats, furniture, and home furnishings comprised 12.7 percent, and residential home improvement loans accounted for 10.5 percent. Personal loans accounted for 34.9 percent and were used primarily for vacations, education, medical expenses, tax payments, and debt consolidations. In contrast with banks, a sizable portion-about one third-of new credit union loan proceeds were used to refinance existing loan balances.

Delinquent loan rates at credit unions are considerably higher than delinquency rates at commercial banks. As of year-end 1975, 3.9 percent of federal credit union loans were delinquent, even though credit union loan delinquencies are not recorded until a loan is at least two months overdue. However, the default rate on credit union loans tends to be lower than that of other consumer lenders. The loan-loss rate for all federal credit unions amounted to 0.32 percent of the dollar amount of total loans outstanding, while similar figures for commercial banks and consumer finance companies are 0.43 and 2.38 percent, respectively. Credit unions appear more willing to renegotiate a loan and convince the delinquent borrower to repay than to write off the loan. They also seem more willing to carry delinquent loans on their books, with delinquency accounting categories of "2-6 months," "6-12 months," and "over 12 months."

Regulation

Credit unions are chartered under one of forty-six state laws or, in the case of federal credit unions, by the National Credit Union Administration. Only Alaska, Delaware, South Dakota, and Wyoming do not provide for state-chartered credit unions. In general, the power to charter as well as to examine and supervise credit unions resides with the same state agency that regulates state-chartered commercial banks and thrift institutions.

At the national level, the Federal Credit Union Act of 1934 allows federal credit unions to charter in all states. Since 1934, federal regulatory powers have been given to a series of federal agencies: the Farm Credit Administration, from 1934 to 1942; the Federal Deposit Insurance Corporation, from 1942 to 1948; the Federal Security Agency, from 1948 to 1953; and the Bureau of Federal Credit Unions in the Department of Health, Education and Welfare, from 1953 to 1970.

In 1970, Congress created the National Credit Union Administration (NCUA) as an independent regulatory agency for federally chartered credit unions. The NCUA is responsible for chartering, supervising, and examining all federal credit unions. In 1975, 56 percent of all credit unions were federally chartered, with the balance, state chartered. NCUA also writes regulations applicable to the operation of federal credit unions.

Credit unions did not have deposit insurance until October 1970, when Congress enacted legislation providing share insurance for all eligible federal credit unions and state-chartered credit unions. The deposit insurance program, administered by the NCUA, is similar to that provided by the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC). The National Credit Union Share Insurance Fund insures member shares up to a maximum amount of \$40,000-the same limits used by the FDIC and the FSLIC. All federally chartered credit unions are insured, and as of year-en 1975, 30 percent of all state-chartered credit unions representing about half of state-chartered credit assets, were federally insured. The balance is either uninsured or insured through a number of state insurance systems.

Structure of the Industry

The most striking features of credit unions, compared to other financial intermediaries, are their rapid rate of aggregate growth and their relatively small size. As Table I shows, the total assets of credit unions as of December 1975, were \$38 billion, representing less than 3 percent of the assets of depository-type financial intermediaries. In fact, some of the largest commercial banks are larger than the entire credit union movement.

Although small in size, credit unions account for a significant part of the consumer installment credit market (Table 2). Credit unions have increased their share of installment loans from 10 to 16 percent in the last ten years and now rank third behind commercial banks and finance companies. Most of the growth of credit unions has come at the expense of finance companies.

Individual credit unions are also small, compared to other financial institutions (Table 3). At yearend 1975, the average asset size for the 23,000 credit unions in the United States was under \$2 million. Furthermore, 74 percent of all credit unions have assets of less than \$1 million, and less than 7 percent have assets greater than \$5 million. By contrast, at year-end 1975, the 14,000 commercial banks in this country had an average asset size of nearly \$70 million.

The growth of the credit union industry has been extraordinary. From 1950 through 1975, its total assets have grown at a compounded annual rate of almost 16 percent, faster than that of any other financial intermediary. The corresponding annual growth rate for commercial banks was 7.0 percent; for savings and loans, 12.9 percent; for mutual savings banks, 7.2 percent; and for finance companies, 10.3 percent. From 1969, the fifty largest credit unions grew an annual growth rate of 17.6 percent, as opposed to 14.6 percent for the smaller credit unions. Large credit unions-which may pose the greatest competitive threat to commercial banks-are the fastest-growing segment of the credit union industry.

An unusual feature of the credit union sector is the high rate of liquidation of credit unions. Between 1934 and 1975, nearly 7,900 federal credit unions with total shares of \$229 million were liquidated. The majority of these liquidations was concentrated among smaller occupational credit unions. The liquidations most often resulted from either a closing of the members' place of employment or a lack of membership. Most liquidations were voluntary and not at the request of regulatory authorities.

TABLE 1
GROWTH OF DEPOSIT-TYPE FINANCIAL INTERMEDIARIES, 1950-1975

	<i>Total Assets</i>						
	<i>December 1975</i>				<i>December 1950</i>		
	<i>Rank</i>	<i>Billion Dollars</i>	<i>Percent of Total</i>	<i>Rank</i>	<i>Billion Dollars</i>	<i>Percent of Total</i>	<i>Percent Annual Growth Rate</i>
Commercial banks	1	\$965	63%	1	\$148	75%	7.8%
Savings and loan associations	2	338	22	2	17	8	12.7
Mutual savings banks	3	121	8	3	22	11	7.1
Finance companies	4	61	4	4	9	5	7.8
Credit unions	5	38	3	5	1	1	5.7

SOURCE: Board of Governors of the Federal Reserve System.

TABLE 2
INSTALLMENT LOANS BY LENDERS
(December 31, 1965 & 1975)

	1965	1975
<i>Type of Lender</i>	<i>(Percent)</i>	<i>(Percent)</i>
Commercial banks	40.9%	46.8%
Finance companies	33.6	24.0
Credit unions	10.3	15.7
Retail outlets	13.8	11.3
Miscellaneous lenders	1.4	2.22
TOTAL	100.0%	100.0%

SOURCE: CUNA.

TABLE 3
RELATIVE SIZE OF SELECTED FINANCIAL INTERMEDIARIES
(December 31, 1975)

	Total Assets (billion dollars)	Number of Institutions	Average Size (million dollars)
Mutual savings banks	\$121.1	476	\$254.4
Savings and loan associations	338.4	4,964	68.2
Commercial banks	964.9	14,633	65.9
Finance companies	60.6	2,961	20.5
Credit unions	39	22,980	1.7

SOURCE: National Consumer Finance Association.

IMPORTANT DIFFERENCES

The major differences between credit unions and other depository institutions are the requirement of a common bond of association among members of credit unions and the fact that most loans by credit unions are consumer loans. However, other important differences exist.

Bond of Association

The common 'bond requirement is one of the most important concepts of the credit union movement. Federal law provides that "credit unions' membership shall be limited to groups having a common bond of occupation or association, or to a group within a well-defined neighborhood, community, or rural district." The most frequent type of common bond applies to employees of a particular firm, with such "occupational" credit unions comprising 56 percent. "Associational" credit unions based on common bonds such as a member's union, religious, or professional affiliation account for 17 percent of the total. This is followed by credit unions for federal, state, and local government employees (15 percent); credit unions related to educational institutions (8 percent); and residential credit unions (4 percent).

In recent years, federal and state regulatory agencies have liberalized the common bond requirement. For example, looser interpretations have allowed the formation of "limited income" credit unions, whose common bond is poverty. In addition, urban neighborhood credit unions have been formed, whereas the original congressional intent was to facilitate credit union growth in rural farming communities. Potential membership has also been expanded by allowing "occupational entities" such as shopping centers and office buildings to form credit unions. Large occupational credit unions have been allowed to merge with small non-related credit unions, partially to ensure the survival of the smaller credit unions. In addition, credit unions are allowed to have "once a member, always a member" rules, plus rules that allow all members of a family to join.

State statutes generally have the, same requirements for chartering, with some exceptions. Occupational credit unions, or those based upon associations through fraternal, religious, or labor groups' are universally recognized. However, state laws are not consistent with regard to neighborhood or community credit unions. For example, Indiana prohibits all residential credit unions, while Maryland limits them to rural areas.

Taxation

Federal credit unions are generally exempt from taxes on their income or financial assets by any level of government. Real property, such as land or buildings, and any income derived from noncredit union activities is fully taxable. Taxation of state credit unions vary with the states. For example, some states such as North Dakota conform, to the Federal Credit Union Act and do not tax credit unions; other states tax credit unions similarly to mutual savings banks and savings and loan associations; and a few tax credit union income similar to corporations. Still, the tax burden for credit unions, as compared to other financial intermediaries, is generally quite light.

Some financial institutions argue that credit unions enjoy inequitably favorable tax treatment. However, credit unions are basically nonprofit institutions, paying out almost all their earnings either in operating expenses or in distributions to current members,. While federal and state regulatory authorities require that credit unions accumulate a certain portion of their annual revenues in the form of reserves, in the aggregate, total credit union reserve accumulations are not excessively large. Federally insured credit unions at year-end 1975 had "Statutory" (regular) reserve holdings of less than 5 percent of total assets, while all other reserves (e.g.,

contingency and loss reserves) amounted to less than one percent; undivided earnings were only slightly more than one percent.

As credit unions gain expanded lending and borrowing powers, their tax-exempt status may be threatened. Other financial intermediaries argue on the grounds of equity that as credit unions become more like other depository institutions, they should be similarly taxed.

Loan Limitations

In the past, credit unions have been restricted by various state and federal laws regarding the type, size, and maturity of the assets they can acquire. The recent extension of Regulation Q, however, has given federal credit unions' expanded lending powers, and the composition of the loans they grant can be expected to change in the future. For example, the majority of credit unions (all federally chartered and many state-chartered credit unions) were effectively prohibited from making mortgage loans because of a ten-year loan maturity limitation. This limitation was extended to thirty years for federal credit unions in the 1977 Regulation Q extension. In addition, federal credit unions can now make conventional home improvement loans and mobile home loans with maturities up to fifteen years.

In the thirty states where credit unions have been previously allowed to make mortgage loans, such loans amounted to 15 percent of total state-chartered credit union assets at year-end 1975. But many small credit unions are reluctant to commit a large portion of member savings to a single loan. It is also felt that multiple small loans are more in keeping with the credit union cooperative spirit. However, if credit unions either increase their ability to tap national money markets or if more efficient secondary mortgage markets should develop, they may be much more willing to make large single loans in the future.

Another restriction on credit unions has been on loan limits. Until passage of the Regulation Q extension bill, for instance, federally chartered credit unions could not make unsecured loans larger than \$2,500. That restriction has now been removed, and the establishment of federally chartered credit union loan size limits is under the discretion of each credit union's board of directors, subject to the proviso that loans to any one individual may not exceed 10 percent of the credit union's total capital.

Rate Ceilings on Loans

Federally chartered credit unions are not allowed to charge more than one percent per month (12 percent APR) on loans to their members. Since such loans account for nearly 75 percent of total assets, this regulation effectively limits potential earnings. Furthermore, this rate typically includes all costs of making the loans as well as the cost of any borrower life insurance and disability insurance. State-chartered credit unions are subject to a variety of loan rate ceilings, but generally they too are restricted to a one-percent-per-month maximum rate of charge.

Share Drafts

Credit unions have recently begun to expand their deposit activities by providing third-party payment instruments called "share drafts," which are functionally equivalent to NOW accounts. At present, credit union statutes in only four states specifically authorize third-party payments, and federal and most state laws remain silent on this question. In August 1974, the NCUA granted three federal credit unions temporary authority to begin offering share drafts., These credit unions were joined by two state credit unions in a six-month pilot program. Upon completion of the program, additional credit unions were given the power to issue share drafts.

As of August 1976, nearly 300 credit unions were offering share drafts to over 90,000 individual accounts, through a program sponsored by the Credit Union National Association (CUNA). An additional forty credit unions were offering share-draft accounts outside the CUNA program.

Delinquent, loan rates at credit unions are quite high.

While share drafts are cleared through the commercial banking system, the process used to clear share drafts differs from that used for commercial banks' checking accounts. A credit union member's share draft follows the normal bank check clearing process, until it reaches the bank upon which the share drafts are payable. At this juncture, the bank makes a photocopy of the draft and sends the -information electronically to the credit union. Itemized statements are prepared and sent periodically-usually monthly-to the member. When a share draft is created, a credit union statement is produced simultaneously by duplicating entries on the share draft. These statements are the legal equivalent of a canceled check. Transaction costs are reduced by truncating the transmission process of payable share drafts at the bank. The yield on share-draft accounts is generally paid on the minimum balance over the payment period. As a result, the effective interest yield to the customer may be substantially less than the stated rate on share-draft accounts.

When the NCUA issued proposed regulations specifying conditions under which it would allow credit unions to issue share drafts, the American Bankers Association (ABA) filed suit against the NCUA asking that credit unions be prohibited from offering share-draft accounts. After the NCUA agreed to suspend the expansion of share-draft programs until completion of the final regulations, the ABA temporarily withdrew its suit pending completion of those regulations. Whether non-bank financial institutions should have third-party payment privileges still remains a controversial issue.

At present, no statutory reserve requirement exists for share-draft balances. However, because of the "near money" nature of these third-party payment accounts, the NCUA requires that participating credit unions hold a 7 percent "liquidity reserve" to back such balances. The liquidity reserve may be held in the form of interest-bearing short-term notes. As share drafts grow, it is likely that the Federal Reserve will attempt to convince Congress that, to promote effective monetary control ' share-draft liquidity reserves should be held on deposit in the Federal Reserve System-as is currently* the case with member bank reserves on checking accounts.

Rate Ceilings on Deposits

Interest ceilings on deposits for credit unions are generally higher than those imposed upon other financial intermediaries. The Federal Credit Union Act limited dividends for many years to 6 percent, and in 1973 it was raised to a maximum of 7 percent annual rate on member share accounts. The rate ceiling is established by the National Credit Union Administration after consultation with other financial regulators. In contrast, the passbook rate ceilings for commercial banks and savings and loan associations are 5 and 5 1/4, respectively. Only bank and savings and loan association certificates of over \$1,000 with a maturity greater than four years are allowed to pay nominal interest rates greater than 7 percent.

As of year-end 1975, more than half of all federal credit unions paid dividend rates of 6 percent or more. State-chartered credit unions are allowed to pay a variety of "dividend" rates, depending upon applicable state laws and regulations. State ceilings vary from a low of 5 percent per year for New Hampshire to no limit in other states. The rate is generally paid on the members' minimum monthly or quarterly balance.

Other Sources of Funds

In recent years, credit unions have been allowed to experiment with different "dividend" rate schemes, and the latest extension of Regulation Q authorized federal credit unions to pay different rates on share deposits of different maturities. Credit unions believe this will give them the flexibility they need to compete for rate sensitive deposits at competitive rates. Conceptually, this poses some difficulty in its suggestion that different classes of "share-holders" exist-and credit unions are supposed to be equalitarian institutions. It may also blur share and liability distinctions.

Historically, credit unions have not had serious liquidity problems. Prevailing rate ceilings on share accounts, presently 7 percent for federal credit unions, have allowed them to compete effectively for passbook savings. Also, credit unions have been able to circumvent restrictions on maximum dividend rates and still compete for interest-sensitive funds by issuing liabilities-variously called "certificates of indebtedness" or "notes payable." Such liabilities are not subject to rate ceilings, and can be issued to non-credit union members as well as credit union members. However, there are two restrictions that limit the popularity of such liabilities. First, credit union liabilities are usually limited to 50 percent or less (depending upon applicable regulations) of their total balance sheet. Second, such liabilities are not insured. Consequently, at year-end 1975, they accounted for less than 5 percent of total credit union liabilities.

An option open to some state-chartered credit unions is to issue deposits with a guaranteed return that is somewhat higher than the dividend rate paid on regular shares. These deposits are subordinate to share accounts in case of liquidation. To date, deposit accounts are not widely employed, amounting to about 10 percent of total savings in the states where they are permitted.

Other Differences

Because of their cooperative nature and frequent association with a "parent" organization, credit unions receive volunteer labor and free services such as office space, utilities, and accounting services. These subsidies are more extensive in smaller occupational credit unions. Occupational credit unions receive more subsidies than associational credit unions and both receive more subsidies than residential groups. Larger credit unions tend to be more like other financial intermediaries in that they receive fewer subsidies, pay higher salaries, and hire professional management.

Credit unions enjoy a stable inflow of funds because of the widespread use of payroll deduction plans. Research by the Credit Union National Association (CUNA) indicates that once a credit union member signs up for a payroll deduction plan, he generally does not terminate it during his employment tenure. Various writers have argued that payroll deduction plans may lower operating costs, raise savings flows, and/or reduce delinquency rates. In addition, payroll deduction provides a particularly effective way to obtain quick and accurate information on changes in borrower earnings or employment status.

The cooperative nature of credit unions provides them with certain advantages vis-a-vis other financial institutions. Tax advantages resulting from their cooperative nature have been cited earlier. In addition, credit unions are able to form cooperative associations, service organizations, and "central" credit unions that further their common interests.

Cooperation among credit unions is greatly facilitated by the common-bond requirement because, theoretically, credit unions with different "common bonds" do not compete for the same customers or in the same market. Thus cooperation does not necessarily reduce the number of options available to individual consumers and, as a result, credit union cooperation is generally immune to antitrust prosecution.

Credit unions can cooperate in joint "state central" or even "U.S. central" credit union organizations. The centrals allow them to pool liquid funds and channel them to credit unions with the greatest loan demand. For example, CUNA has recently formed a U.S. central which plans to provide credit unions with additional funds by tapping national and international money markets, and to supply credit unions with a multitude of additional financial management services-possibly even bank credit card services. Credit unions may also buy computer and insurance services from cooperatively initiated service organizations-such as CUNA data or Curia Mutual. They can also cooperate easily in other joint ventures. For instance, several Texas credit unions have banded together to buy a bank in order to obtain access to bank card clearing systems, Kansas credit unions bought a bank to ensure access to national payments systems; Washington, D.C., area credit unions jointly participate in an electronic terminal system.

Unlike banks, credit unions are in the favorable position of being regulated by an organization that is explicitly charged with the responsibility of promoting their development. Consequently, the NCUA is more likely to take a sympathetic, rather than adversary view, toward their requests. And it may advocate congressional legislation favorable to credit unions. Legislators are often sympathetic to credit union interests because credit unions have an image of helping the small borrower by providing small loans at relatively low interest rates. Furthermore, with nearly 23,000 credit unions and over 34 million members, a large number of people have an interest in the welfare of the credit union movement.

POTENTIALS FOR CREDIT UNION GROWTH

In the future, credit unions are likely to continue to grow rapidly and make greater inroads into traditional banking markets. Legislation recently enacted has set the stage for a major expansion in credit union activities-both by increasing their abilities to cooperate and to tap national money markets. Also, regulations that curtail the flow of information to potential and actual creditors may indirectly benefit credit unions. However, credit unions may still unofficially obtain particular items of restricted information because of their access to membership applications or through informal channels such as the office grapevine. Aggressive development of credit union cooperative ventures should enable also even relatively small credit unions to obtain the funds and financial and technical expertise they need to grow at relatively low cost.

Several factors could adversely influence credit union growth, though. Most pertinently, as EFT systems develop, credit unions may lose some of their present competitive advantages, as other financial institutions will more easily be able to obtain savings flows or loan repayments via payroll deductions from workers' paychecks. With EFTS, the job-site convenience of many credit unions for offering face-to-face financial transactions is likely to diminish in relative importance as a factor affecting consumers' choice of a financial institution. Also, regulatory "common bond" restrictions may reduce the potential for individual credit union growth. These growth restrictions may make it difficult for individual credit unions to afford the financial and technical expertise needed in order to computerize, enter EFT systems, and to perform other financial functions where scale economies are important. Finally, rate ceiling restrictions could make it difficult for credit unions to obtain and earn an adequate return on their funds if interest rates were to rise sharply due to accelerating inflation.

Long-Range Plans

Long-range plans of the main credit union trade association, CUNA, are to overcome diseconomies of small individual credit union size by forming cooperative arrangements that will enable many credit unions to participate jointly in various undertakings. As a result, CUNA is (1) developing a U.S. central credit union, (2) negotiating with National Bank Americard about potential membership in its VISA bank card system, (3)

investigating the possibility of issuing commercial paper and/or long-term debt through the U.S. Central Union in order to attract additional funds into the credit union movement and provide for individual credit unions' fluctuating liquidity needs—thereby, allowing them to loan out a higher proportion of their portfolio, and (4) planning to establish facilities in the U.S. Central for aiding credit unions in the initiation and marketing (in the secondary mortgage market) of home mortgage loans.

A long-range objective of these plans is to provide facilities, so that credit unions can become *full-service* financial institutions. In that way, credit unions hope to be able to retain customer loyalty even though they may lose present competitive advantages in offering convenient service and payroll deductions as EFT systems develop. A second objective is to enable credit unions to overcome diseconomies of scale caused by the small size of the majority of all credit unions. By buying specialized expertise and equipment centrally, and allowing all credit unions, to share in the use of such services through cooperative arrangements, individual credit unions will be able to offer a wider variety of services, with greater efficiency than would otherwise be the case. Services that have been or could be provided on a cooperative basis include credit insurance, share-draft processing, data processing and accounting services, participation loans, liquidity transfers, portfolio analysis, and investment advice and intermediation.

Recent Legislation

The recent extension of Regulation Q ceilings, mentioned previously, gave credit unions these important new powers:

- *Real estate loans:* The Act permits loans for purchase or construction of family residential dwellings with maturities up to thirty years.
- *Mobile home and home improvement loans:* The Act permits conventional mobile home and home improvement loans with maturities up to fifteen years.
- *Loan maturities:* The Act raises the, maximum loan maturity for unsecured or secured consumer or personal loans to twelve years.
- *Unsecured loan ceiling:* The Act removes the dollar limit on unsecured loans to one member. The board of directors of each credit union would determine the unsecured loan limit.
- *Lines of credit:* Credit unions are permitted by the Act to offer self-replenishing lines of credit so that advances to members can be made immediately without approval from the credit union's credit committee.
- *Type of member accounts:* The Act allows credit unions to offer members varying rates of returns on shares and share certificates according to classification and maturity.
- *Purchase and sale of member notes:* The Act allows credit unions to purchase, sell, or discount any eligible obligations of their members.
- *Regarding loans to other financial institutions.* The Act allows credit unions to make loans to other credit unions, or to share in participation loans between credit unions and other financial institutions.
- *Sale of assets:* The Act allows credit unions to sell their assets or purchase assets of another credit union. It also allows them to assume the liabilities of another credit union or its members.

Future Trends

Both greater cooperation among individual credit unions and recent relaxations in legislative and regulatory restrictions will allow credit unions to (1) overcome many disadvantages posed by their present small average size, (2) obtain specialized financial and computer services, (3) increase their ability to tap commercial markets

and employ surplus funds effectively, and (4) expand their powers and become "full service" financial institutions in the future. As a result, credit unions can be expected to compete aggressively with commercial banks in the household deposit market, as well as in the consumer and mortgage loan markets.

At the same time, however, certain banks may be able to take advantage of credit union growth -by offering credit unions access to financial markets, bank card and check clearing systems, and specialized computer facilities - that individual credit unions would find difficult or impossible to obtain by themselves. Credit unions are therefore likely to become greater competitors with commercial banks in some markets, while simultaneously becoming more important customers of banks in other markets.