TESTIMONY OF

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BEFORE THE

INDUSTRY BUSINESS AND LABOR COMMITTEE
NORTH DAKOTA SENATE

AT A HEARING FOR SB2266

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Testimony of
Mike Schenk, Deputy Chief Advocacy Officer for Policy Analysis and Chief Economist, Credit Union National Association
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Chairman Larson and Members of the Senate IBL Committee:

My name is Mike Schenk and I am the Chief Economist for the Credit Union National Association (CUNA). CUNA is the largest trade association serving America's credit unions. CUNA membership stands at its highest level in over a decade with nearly 90% of the nation's 5,000 federal and state credit unions affiliated. On behalf of these credit unions and their more than 130 million members, thank you for the opportunity to testify on this extremely important topic.

Credit Unions are Different

Credit unions are **uniquely structured** - distinguished by a not-for-profit status – with earnings returned to members (i.e., to depositors) in the form of lower loan interest rates, higher savings yields and generally fewer and lower fees. Depositor-ownership is based on democratic principles – wherein each and every member has one vote in governance – whether they have $1 or $100 or $10,000 or more in total deposits.

Throughout history, the structure has consistently produced significant pro-social outcomes – including both large financial and non-financial benefits that simply don't occur in the for-profit financial services arena: For-profit, stockholder-owned financial services firms focus on maximizing the value of stockholder investments. – and they have a fiduciary obligation to do so.

In contrast, their unique structure means that credit union managers have a singular focus on serving members. Without outside stockholders demanding a market rate of return on their investment they lack any incentive to mistreat their member-owners (evident in far fewer fines & settlements) and they take substantially less risk – resulting in far fewer financial disruptions and failures compared to the for-profit segment of the industry.

Credit unions have a unique tax status which derives from their unique structure. That's important to note because some observers seem to think otherwise. To be clear: the credit union tax status has absolutely nothing to do with service offerings. Or asset size. Or growth rates. Or earnings. And it has absolutely nothing to do the breadth of membership fields.

Field of Membership Modernization for North Dakota Credit Unions – SB2266 - Protects Financial Choice for North Dakotans and would Increase Safety and Soundness

North Dakota state chartered credit unions operate under one of the strictest Field of Membership (FOM) statutes in the nation, particularly in comparison to federally chartered credit unions. Currently, only those residing within 75 miles of a credit union's home office, or similar limited radius of a branch, can be a member of an "open charter" North Dakota state chartered credit union.

- In contrast, regulatory changes over the past forty years have allowed several thousand U.S. credit unions to expand membership fields and many have converted to community charters.

These changes increased and diversified credit union membership significantly - and much more broadly than what North Dakota law allows.

- Some say that these developments increase risk as the social capital of tight common bonds becomes diluted. But – on the contrary – rigorous academic research consistently shows that broadening credit union fields of membership improve safety and soundness by enabling credit unions to diversify their loan portfolios.

- This has been clearly outlined in academic literature, most recently, in a June 2022 Working paper titled "***The Effects of Membership Expansion on Credit Union Risk, Growth and Returns".*** Authored by Jordan van Rijn, – PhD, Associate Lecturer at the University of Wisconsin Madison in the Department of Agricultural and Applied Economics - the working paper improves on previous cross-sectional studies by utilizing a generalized difference-in-differences model with credit union and quarter fixed effects over 25 years (1994 to 2017). Put simply, rather than studying credit unions with wide fields of membership and those with narrower fields of membership at a point in time (as was the case in previous studies) van Rijn's analysis statistically evaluates changes in operating outcomes over a long period of time – nearly 25 years.

- van Rijn's more comprehensive analysis confirms the results of previous less rigorous studies, once again finding that – to use his words - "wider credit union fields of membership unambiguously improve credit union returns, reduce risk (as measured by the standard deviation of earnings and the probability of liquidation or merger) and have no effect on the probability of exhausting net worth." Specifically, he finds that the annual probability of liquidation or merger is reduced by 10% overall. He notes that there is some evidence of an increase in delinquencies, but no effect on other indicators of asset quality: in other words delinquencies rise modestly on average but net.chargeoffs do not.

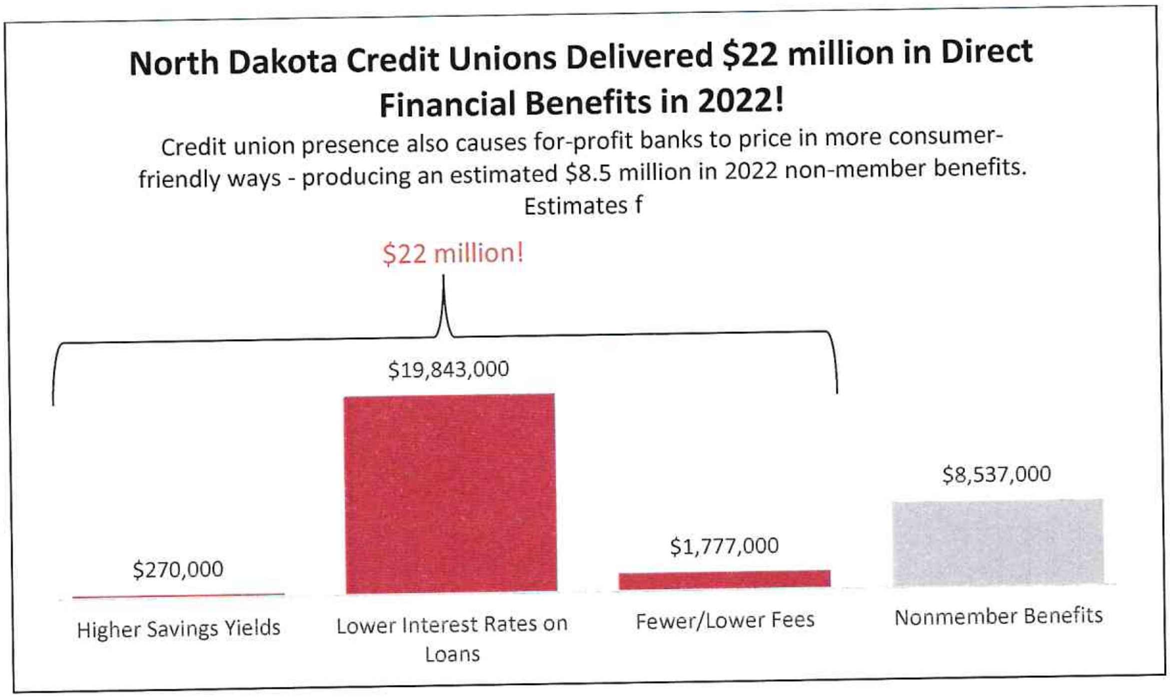
- He concludes: "These findings imply that the transformation of the U.S. credit union industry towards a greater proportion of community charters and expanded fields of membership is a positive development for the financial sector. In general, it appears to reduce risk and improve credit union returns, the latter of which can be used for better interest rates and more products and services for consumers. The reduced risk also puts less pressure on the credit union regulator to encourage mergers or to use insurance funds to deal with financially challenged institutions." Given the trade-off between risk and returns, it is particularly noteworthy that both the earnings and risk profile of credit unions improve after conversion.

Credit Unions have no Stockholders so they Pass Earnings Directly Through to their Member-Depositors – Helping them Save Hundreds or Thousands of Dollars Annually. van Rijn's Research shows these Financial Benefits can be Enhanced with Wider Membership Fields that Promote Financial Stability.

- In the year ending September 2022, U.S. credit unions delivered nearly $14 billion in direct financial benefits to their members - arising from lower loan interest rates compared to banks, higher savings yields compared to banks and fewer/lower fees compared to banks. **North Dakota credit unions delivered nearly $22 million in direct financial benefits in that 12-month period ending September.** A concrete example of the significant savings that accrues can be seen in the auto lending arena: Based on recent Datatrac pricing survey data North Dakota consumers who choose to finance auto purchases at North Dakota credit unions save roughly $1,900 over the life of their five-year car loans – a substantial savings for many average consumers – many of whom live paycheck-to-paycheck.

- Nationally, we estimate that bank customers also saved over $5.5 billion in 2022 because their banks price in more consumer-friendly ways than they otherwise would when faced with credit union competition. In North Dakota, this indirect benefit totaled $8.6 million in the year ending September 2022.

- These results are consistent over time: U.S. credit unions delivered over $140 billion in financial benefits over the past fifteen years – and in North Dakota the total over that 15-year period is $270 million.



Importantly, CUNA's standard analysis of credit union member financial benefits is based on average pricing data provided by Datatrac – one of several national independent survey firms that tracks financial institution product pricing. These surveys focus on pricing (i.e, advertised interest rates) for "A" paper in the lending arena. CUNA has recently obtained the Equifax database and the information therein substantiates what we've seen in several academic papers. Specifically it confirms the comparisons and observations we've historically communicated – but also shows that credit union pricing is ***substantially more*** consumer-friendly for consumers with lower credit scores.

The data shows more favorable credit union loan picing compared to banks – but (by far) the most significant differences are seen when comparing credit unions to auto finance company pricing (in the auto lending arena) and when comparing credit unions to mortgage brokers (in the mortgage arena).

For example, in the third quarter of 2022 near-prime borrowers (with credit scores between 620 and 659) reflected average financing rates of 5.40% at credit unions but 11.68% at auto finance companies on six-year car loans – that difference saves credit union borrowers $7,052 compared to what they would pay over the life of a six-year $38,000 loan were they to use a finance company.

During the same period, deep subprime borrowers (with credit scores below 580) reflected average financing rates of 5.97% at credit unions but 20.09% at auto finance companies on six-year car loans – that difference saves credit union borrowers nearly $17,000 compared to what they would pay over the life of a six-year, $38,000 auto loan were they to borrow from an auto finance company.

North Dakota Credit Unions Serve Average Consumers

Wider fields of membership will mean that many of North Dakota's vulnerable consumers will have better access to safe, affordable credit. For example, we note:

- The most recent (2019) Federal Reserve Survey of Consumer Finances reveals that, nationally, the annual average income of primary bank customers (those that do all or most of their business with banks) is 27% higher than primary credit union customers. Primary bank customers report average net worth that is more than double primary credit union customers.

- The most recently-available HMDA data – which reflects lending and borrowing in 2021 - shows that compared to North Dakota credit unions, the state's banks were 1.4 times more likely to originate purchase money mortgages to high income consumers with 40% of total bank originations in this demographic group. Only 29% of North Dakota credit union originations were to high income borrowers. At the other end of the spectrum, HMDA origination data shows credit unions are 1.3 time more likely than banks in the state to originate purchase money mortgages to low/mod income consumers (i.e., those with incomes that are lower than 80% of area median).

- North Dakota credit union purchase money mortgage borrowers reflected an average income of $96,059 while bank borrowers in the state had an average income that was 18% higher - $113,095.

- Home Mortgage Disclosure Act data for 2021 purchase money mortgages in North Dakota reveals credit union loan size averaged $210,328 while banks and mortgage brokers report average purchase money mortgage loan size that is 10% higher than the credit union norm – averaging roughly $229,000.

- In the auto lending arena recent Equifax auto loan origination data tells a similar story. Contemporary data reveals that North Dakota banks are 1.3 times more likely to originate super-prime auto loans than are the state's credit unions. While North Dakota credit unions are over two times more likely than banks to originate auto loans to consumers with below prime credit scores.

Credit Union Members in North Dakota's Rural Communities would Likely Benefit Most from SB2266

Credit union members are clear about one thing: They believe that their not-for-profit, member-owned credit unions are their best financial partner and recognize that they advance the communities they serve in meaningful ways.

Recent CUNA research reveals credit union members reflect substantially greater financial resilience than consumers who do not use credit unions. Credit unions members are significantly more likely than nonmembers to use financial education and counseling services. Members are therefore both much more likely to engage in behaviors that improve financial well-being AND to say that their financial institution has actually improved their financial well-being.

Credit union members who reside in rural communities are especially impressed with their credit unions.

CUNA's 2022 National Voters Poll makes the beneficial effects of these outcomes abundantly clear. The Poll includes questions about financial institutions and their effectiveness in improving consumer financial wellbeing and in advancing the communities they serve. The online panel survey, conducted by FrederickPolls during January 2022 is based on a nationally representative sample of 2,500 voters (with a margin of error equal to + 2%). Questions center on financial behaviors and outcomes, trustworthiness, and connections to the local community.

In North Dakota these views are especially important. Survey results in rural areas are especially favorable for those who reside in rural areas. That's critically important because both the CFPB's recent study on financial issues facing rural communities and historical USDA research show rural areas are particularly stressed financially with the combination of relatively high poverty rates and financial access issues exacerbated by bank branch closures and banking deserts.

CUNA's 2022 Voter Poll reflects these concerns: Over half (54%) of respondents who live in rural areas say that their local economic conditions are "somewhat" or "very" negative. In addition, nearly one-third (32%) say that their household's overall income is lower today as compared to pre-Covid pandemic levels of 2019.

Rural residents are approximately 2.5 times more likely than those who live elsewhere to say that there is not enough access to banks and credit unions in their community.

Importantly, rural residents who are credit union members reflect substantially greater financial resilience than rural residents who do not use credit unions. The differences we find appears to arise from credit unions' more consultative approach, more consumer-friendly pricing, thoughtful products and services and an overall sense of trust fostered by these institutions.

Financial Well-being for All

CUNA 2022 National Voter Poll: Rural Consumers

	Rural CU Members	Rural Nonmembers	Difference
Spending: Makes it easy to manage my finances (% very positive)	60%	39%	21%
Saving: Does not have $500 emergency savings (% without)	33%	49%	-16%
Borrowing: Ease of getting a loan (% very positive)	52%	18%	34%
Borrowing: Low-cost loans (% very positive)	52%	20%	32%
Planning: Have used personal financial ed/counseling service (% use)	28%	16%	12%
Overall: Cares about my FWB (% very positive)	50%	26%	24%
Overall: Has positively impacted my FWB (% very positive)	55%	27%	28%

Trust, Service & Community Focus

	Rural CU Members	Rural Nonmembers	Difference
Can trust them (% very positive)	65%	39%	26%
Knows you (% very positive)	44%	33%	11%
Responsive customer service (% very positive)	67%	43%	24%
Provides technology to do remote banking (% very positive)	63%	45%	18%
Serves diverse customer base (% very positive)	61%	35%	26%
In touch with local community (% very positive)	56%	34%	22%
Cares about local community (% very positive)	59%	34%	25%

Specifically, we find:

• Rural residents who are credit union members are 1.8 times more likely than nonmembers to say they have received financial personalized financial education/counseling.

• Rural residents who do not use credit unions are nearly 1.5 times more likely than rural residents who are members to say that they have NOT established a financial buffer to meet unexpected expenses.

• Rural resident credit union members are over two times more likely than nonmembers to say they are "very positive" their financial institution has improved their financial well-being. As shown in the tables, polling results detail similar positive differences across ten other dimensions related to financial well-being including those related to trust, service provision and community focus. These results are consistent across all demographic groups examined – especially among those who live in rural areas.

Banks Dominate in North Dakota and SB2266 Would Not Change That

Contrary to oft-repeated banker rhetoric North Dakota credit unions do NOT represent an existential threat to banks. Banks are growing quickly, reporting record profits and record stockholder dividends:

- Banking institutions have an overwhelming market dominance in North Dakota - reflected in an 90% market share of total financial institution deposits at mid-year 2022.
- North Dakota bank deposits have grown by $10.1 billion in the past three years – 2.25 times MORE than North Dakota credit unions have grown since beginning operations in the state roughly 100 years ago.
- The state's billion-dollar banks now control two-thirds of total financial institution deposits in the state – a market share that has increased by roughly 40 percentage points in the past 25 years.
- Out-of-state banks operating in North Dakota increased their market share by seven percentage points over that same 25-year period. They now control nearly one-quarter of all financial institution deposits in the state - an erosion of local control that results in capital outflows from the state.
- The two largest banking organizations operating in North Dakota – Watford City Bancshares and State Bankshares - report mid-year 2022 North Dakota deposits totaling $7.6 billion – an amount that is 70% greater than the total deposits in all 32 North Dakota credit unions.
- North Dakota banks are growing quickly – reflected in average asset growth of 12% annually over the past five years.
- North Dakota banks collectively report very strong earnings:_ Annualized profits at North Dakota banks totaled $623 million through September 2022– and hit consecutive all-time highs in 2020 and 2021. ROA (net income as a percentage of average assets) averaged 1.35% over the past decade.
- Bank stockholder dividends are soaring – with banks headquartered in North Dakota reporting a record total of $419 million in total dividend payments in 2021.
- On the margin, the modest changes reflected in SB2266 would have little effect on bank growth or profitability but could help more average North Dakotans increase financial resilience.

A Note on Credit Unions & Taxation

Some say credit unions pay no taxes. That's patently false. Credit unions and their member-owners pay a wide variety of taxes annually and the total payments are large and growing. These taxes include FICA taxes, excise taxes, license fees, sales taxes, property taxes and severance taxes.

- According to CUNA's IMPLAN Impact analysis for 2021, North Dakota credit unions account for $14.3 million in direct federal tax payments and account for a total of $25.0 million in direct and indirect federal tax revenue.
- In addition, IMPLAN analysis shows North Dakota credit unions accounted for roughly $8.5 million in direct state & local tax payments and a similar total in direct and indirect state & local taxes revenue.
- In other words, North Dakota credit unions accounted for a TOTAL of $23 million in direct tax payments in 2021 and a TOTAL of over $33 million in direct and indirect tax payments in the year.
- The 214,00 average consumers who choose to be credit union member-owners in North Dakota collectively account for billions of taxes annually. Indeed, CUNA conservatively estimates credit union members in North Dakota paid $3.3 billion in state and federal income taxes in the most recent tax year.
- Against this backdrop, it is interesting to note that the 2017 federal income tax reform bestowed big, permanent tax benefits to banks – both nationally and in the state of North Dakota. The tax reductions from those reforms greatly exceed the value of the credit union tax expenditure. In addition, thousands of banks nationally (and dozens in North Dakota) enjoy SubChapter S status – which reduces tax obligations substantially.

Conclusion

On behalf of CUNA, thank you for the opportunity to speak to you today. I'd be happy to address any questions you may have.

Mike Schenk, Deputy Chief Advocacy Officer for Policy Analysis and Chief Economist