ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA®

July 7, 2021

The Honorable Janet Yellen
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Yellen:

On behalf of community banks across the country, with more than 50,000 locations, I write to call your attention to an emerging trend and abuse of the tax code: A surge in credit unions purchasing community banks – effectively leveraging their tax exemption to exacerbate consolidation among financial institutions. Just last month, a Michigan state-chartered purportedly "low-income" credit union announced the purchase at twice book value of a Florida bank specializing in aircraft financing for high-net-worth individuals. We believe such transactions flout the original purpose of the credit union tax exemption, to serve people of modest means, and request that you direct your attention to this issue and take appropriate steps, administratively and in conjunction with Congress. Attached for your consideration is proposed legislation that would tax credit union acquisitions of taxpaying banks to capture the future value of the tax revenue that is lost once the business activity of the acquired bank becomes tax exempt.

America's community banks are small business lending experts in the thousands of rural, urban, and suburban communities they serve. Community banks have made nearly 60 percent of Paycheck Protection Program loans, over 60 percent of PPP loans to women-owned and veteran-owned small businesses, and 43 percent of PPP loans to minority-owned small businesses. Many of these small businesses had been turned away from larger banks. Community banks processed PPP loans five to 10 days faster than other PPP lenders when time was of the essence. Small business lending is a highly specialized skill dependent on direct knowledge of a community and local economic conditions. Credit union-community bank acquisitions and the rapid expansion of the credit union industry are reshaping the American financial services landscape in a way that puts small business lending experts at risk.

We urge Treasury to examine the causes of the credit union-bank acquisition trend, its impact on small businesses, consumers, and the tax base, as well as appropriate legislative and regulatory responses. Below we provide background to support this examination request.

An Outdated Tax Code Has Created Large, Rapid Growth Credit Unions Which Absorb Most of the Tax Subsidy

In the last five years alone, the total assets of federally insured credit unions have grown by more than $610 billion, about 52 percent, and membership has grown by 21.7 million, over 21 percent, while the total number of credit unions has declined by 957, or 16 percent. Today there are more than 364 credit unions with assets of more than $1 billion and 14 credit unions with assets of more than $10 billion, the largest of which has more than $131.6 billion in assets, dwarfing the size of the community banks with which they compete. The largest credit unions are experiencing the fastest growth. The nation's largest credit union, Navy Federal in Vienna, Va., increased its assets by 137 percent between 2013 and 2020. What's more, credit unions with more than $1 billion in assets account for the largest share of the industry's tax subsidy, over 75 percent.

Congress created the tax exemption more than 80 years ago during the Great Depression for a narrow purpose: To ensure that people of modest means with a common bond such as an employer or a union have access to consumer credit. While there are thousands of smaller, limited credit unions that adhere to the original vision, we believe that today's industry – particularly the largest, rapid-growth credit unions as well as those that have ventured into more exotic investments – stands in jarring contrast to the original vision.

Consider, as a recent example, Pentagon Federal Credit Union's partnership with Goldman Sachs to fund the second phase of the District of Columbia Wharf's million dollar plus residences, hotels and marina with a nearly $1 billion loan—the biggest construction loan in D.C. history. It is impossible to ignore just how far credit unions have strayed from their duty to serve people of modest means.

The evolution of the industry is the fault not only of the tax code, but of the increasingly permissive oversight and regulation from the National Credit Union Administration, which has virtually dissolved field of membership limitations and, more recently, given credit unions authority to raise capital through the sale of subordinated debt securities to venture funds and other outside investors.

Bank Acquisitions Are the Next Phase of the Industry's Aggressive Growth

For decades, credit unions have used their tax subsidy and a permissive regulatory environment to expand their market share. What's happening today – credit union "weaponization" of their tax subsidy and lax regulatory environment to purchase whole community banks – is an order of magnitude more significant and warrants Treasury's scrutiny. These deals transform taxable business activity at community banks into tax-exempt activity at credit unions, thereby shrinking the tax base, not only at the federal level but at the state and local level as well.

The trend has sharply increased in recent years. Before 2012, credit union acquisitions of banks or bank assets were limited to two or three a year. They have steadily ramped up since then, accelerating rapidly in 2018, which saw 13 acquisitions, and in 2019, which saw 21, seven times as many as occurred just six years ago.

The acquisition targets have also grown larger. Most recently, in March 2021, VyStar Credit Union, a $10 billion credit union headquartered in Jacksonville, Florida announced the acquisition of $1.6 billion Heritage Southeast Bank, headquartered in Georgia, the largest bank to be acquired by a credit union to date. As noted above, in June 2021, Lake Michigan Credit Union, a $10 billion low-income credit union based in Grand Rapids, Michigan agreed to buy Pilot Bank, a $656 million community bank based in Tampa Bay, Florida which specializes in the financing of private aircraft, for twice its book value. The credit union tax exemption must not be used to subsidize the financing of private aircraft, an unconscionable departure from its original purpose.

These deals have received significant media attention and public interest. Prominent examples include a September 2019 Wall Street Journal article headlined, "Credit Unions Go on Bank Buying Spree," and the December 2019 American Banker article, "Credit Unions' Bank Buyout Spree Snags Biggest Fish Yet." [1]

All indications are that the credit union-bank acquisition trajectory will continue – unless Treasury and Congress exercise needed oversight.

Credit Union-Bank Acquisitions Promote Harmful Consolidation

The purchase of community banks by multi-billion credit unions is a policy concern for the same reason that all financial industry consolidation is a concern: Larger, out-of-market institutions – be they banks or credit unions – displace locally based community banks. A market dominated by large institutions is less competitive, creates systemic risk, and will result in fewer choices for consumers and small businesses and ultimately less favorable rates and pricing. Institution size should be dictated by the marketplace and economies of scale, not by regulatory compliance burden, nor by a distorted tax code that favors one type of financial institution over another and promotes growth-obsessed credit unions.

"Exit fee" Should Be Imposed on Credit Union Acquisitions of Banks

As noted above, when a tax-exempt credit union purchases a tax-paying bank, it is exceeding its tax-exempt mission and removing a taxpayer from the tax base. There is precedent for imposing a fee or excise tax on tax exempt organizations for stepping out of the bounds of their tax exemption. For example, political expenditures of a 501(c)(3) tax-exempt organization are subject to an excise tax.

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[1] Clozel, Lalita. "Credit Unions Go On Bank Buying Spree." Wall Street Journal, September 3, 2019. https://www.wsj.com/articles/credit-unions-go-on-bank-buying-spree-11567515601?mod=searchresults&page=1&pos=3 McCarthy, Ken. "Credit unions' bank buyout spree snags biggest fish yet." American Banker, December 3, 2019. https://www.americanbanker.com/news/credit-unions-bank-buyout-spree-snags-biggest-fish-yet

As set forth in the attachment to this letter, our proposed exit fee would be equal to 10 percent of the gross value of the acquired bank's assets or liabilities as shown on its most recent balance sheet, whichever are greater. The exit fee would be payable by the acquiring credit union.

The purpose of the proposed fee is to capture part of the lost value of taxes that would have been paid by the bank going forward had it remained independent or been acquired by another taxpaying bank.

The exit fee would be calculated on assets or liabilities rather than the net book value of the bank. The reason for this is that in many transactions, a credit union will only buy the loan portfolio or the deposits of a bank. The fee must be structured to account for such transactions. When a credit union does buy a whole bank, the net book value may not be significant if the bank has performed poorly and/or its capital to total assets ratio is low. These transactions must be subject to an exit fee because they increase the market share of a credit union at the expense of a community bank and ultimately reduce the tax base.

Other Legislative and Regulatory Solutions

Treasury should also consider available options for curtailing the credit union-bank acquisition trend, and, more broadly, restoring the original purpose of the tax exemption.

While Congress may currently lack the appetite for creating full and immediate tax parity between credit unions and banks, incremental options should be considered. These options include:

- Taxation of the largest and/or most growth-oriented credit unions.
- Taxation of credit union commercial lending revenues.
- An excise tax on credit union marketing expenditures that exceed a given threshold (e.g., multi-million-dollar stadium naming rights).
- Creating the option for states to tax federal credit unions. While states have authority to tax state-chartered credit unions, state-chartered credit unions can avoid any such tax by switching to a federal charter. However, Congress could give states optional authority to tax federal credit unions that operate within their borders.
- Heightened regulatory scrutiny of credit union-bank acquisitions.

To conclude, if current trends continue, the American financial services landscape will shift rapidly and irreversibly as a result of credit union-bank acquisitions. This is a matter of significant public concern and Treasury and Congress should exercise their oversight authority to examine this troubling distortion.

Thank you for your consideration.

Sincerely,

/s/

Rebeca Romero Rainey
President & CEO

Attachment: Exit Fee on the Purchase of a Bank by a Credit Union

Exit Fee on the Purchase of a Bank by a Credit Union

Purpose: To impose an exit fee on the purchase of a bank, bank assets, or bank liabilities by a credit union.

Reason for Change: The removal of tax paying banks or their assets or liabilities from the tax base by a tax-exempt credit union is beyond the scope of their public mission and should be subject to an exit fee.

Legislative text

Section 1. Exit Fee on the Purchase of a Bank, Bank Assets, or Bank Liabilities by a Credit Union

(a) In General.--Subchapter D of chapter 42 is amended by adding at the end the following new section:

"Sec. 4961a. Exit Fee on the Purchase of a Bank, Bank Assets, or Bank Liabilities by a Credit Union

(a) **Fee imposed.** There is hereby imposed a fee equal to 10 percent of the book value of the assets or liabilities, whichever is greater, of a bank that has been purchased by a credit union. The "book value of the assets or liabilities" of the acquired bank shall be the value of those assets or liabilities as reflected on the books of the bank at the time of the purchase.

(b) **Liability for tax.** The acquiring credit union shall be liable for any fee imposed under subsection (a).

(c) **Definitions.** For purposes of this section—

(1)CREDIT UNION The term "credit union" means any organization which for the taxable year is exempt from taxation under section 501(c)(14)(A) or a federal credit union exempt under section 501(c)(1).

(2)Bank The term "bank" means an organization defined under section 581.

(d) Regulations

The Secretary shall prescribe such regulations as may be necessary to prevent avoidance of the fee under this section."