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# NOTE

## Credit Unions—Regulatory Control Development—Problems—Recommendations

### INTRODUCTION

At the end of 1962, there were 21,032 active credit unions in the United States with 913,113 members. This more than doubled the number of units and members existing in 1950. The savings accounts of this group totaled 6.3 billion dollars; the installment credit totaled 4.9 billion dollars.<sup>1</sup> Although the segment of overall savings and installment credit is small compared to all financial intermediaries,<sup>2</sup> the significant aspect of the credit union system is the dynamic growth it is experiencing. An almost geometric pattern of growth has resulted in the credit union expanding more rapidly than any other financial institution.<sup>3</sup>

1. INTERNATIONAL CREDIT UNION YEARBOOK 2, 7 (1963).

2. Figures are in billions of dollars in first table; second table is in millions of dollars. Courtesy of Federal Reserve System.

Year	Savings & Loan Ass'n	Mutual Savings Banks	Commercial Banks	Open End Mutual Funds	U.S. Savings Bonds	Postal Savings	Credit Unions	Savings in C.U. % Total Savings in U.S.	Total Savings
61	\$70.9	\$38.3	\$74.8	\$22.8	\$46.4	\$ .7	\$5.6	2.2%	\$259.5
60	62.1	36.3	67.1	17.0	45.6	.8	5.0	2.1	233.9
55	32.1	28.1	46.3	7.8	50.2	2.0	2.4	1.4	168.9
45	7.4	15.3	29.9	1.2	42.9	3.0	.4	.4	100.1
41	4.7	10.5	15.5	.4	5.3	1.4	.3	.8	38.1

Year	Total Credit Instal.	All Fin. Inst.	Sales Comm. Banks	Con. Fin. Company	Other Fin. Inst.	Retail Outlets	Credit Unions	% Total Fin. Inst. Held by C.U.'s	Total % Credit Held by C.U.'s	
62	\$48,243	\$41,807	\$18,909	\$12,194	\$4,131	\$1,600	\$6,436	\$4,973	11.9%	10.3%
61	43,530	37,935	17,008	11,273	3,799	1,525	5,595	4,330	11.4	9.9
55	28,906	24,398	10,601	8,447	2,623	1,049	4,508	1,678	6.9	5.8
45	2,642	1,776	745	300		629	686	102	5.7	3.9
41	6,085	4,480	1,726	1,797		759	1,605	198	4.4	3.3

3. In a 1953 study by the Bureau of Federal Credit Unions a projected growth was viewed as overly optimistic. As indicated by the following figures, shown in millions, the actual growth has already exceeded expectations:

*Professional Significance*

An awareness of the credit union, its economic and social impact, has a special significance to the lawyer. Although such significance appears minimized by a dearth of litigation addressed to credit unions in the past,<sup>4</sup> this is not a true reflection of fact; nor would a true history of credit union litigation be a guide to the future. The lack of identifiable credit union litigation is chiefly due to the lack of appreciation by the bench for the distinguishing features of savings and loan associations,<sup>5</sup> commercial banks,<sup>6</sup> and credit unions.<sup>7</sup> Two

Estimated Savings, Federal Credit Unions  
Bureau of Federal Credit Unions, 1953

Year	Assumption I	Assumption II
1965	6,307.7	4,801.8
1970	15,695.7	8,272.7
1975	39,056.0	12,914.6
1978	67,488.8	16,404.6

Assumption I: Shares increase 20% annually 1954 through 1978.

Assumption II: Shares increase annually: 1st 5 years at 20.0%; 2nd 5 years at 16.6%; 3rd 5 years at 12.5%; 4th 5 years at 10% and last 5 years at 8.3%. Table started with 1953.

4. Accounting: See *Social Security Administration Fed. Credit Union v. United States*, 138 F. Supp. 639 (D.C. Md. 1956); *Gilbert v. Beacon Hill Credit Union*, 287 Mass. 433, 192 N.E. 25 (1934).

Application of Value of Stock: See *Merchants' Co-op. Bank v. Pasqualucci*, 289 Mass. 339, 194 N.E. 85 (1935).

Authority of Credit Union to Bind Association or Member: See *Jones v. B. F. Butler Co-op. Bank*, 254 Mass. 82, 149 N.E. 657 (1925).

Creation of a Central Bank: See Opinion of the Justices, 278 Mass. 613, 181 N.E. 836 (1932).

Forfeitures for Non-payment of Loans: See *Lowell Co-op. Bank v. Dafis*, 276 Mass. 3, 176 N.E. 519 (1931).

Loans: See *Post Office Employees' Credit Union v. Morris*, 178 So. 525, *reinstated*, 183 So. 609, *aff'd*, 192 La. 891, 189 So. 566 (1939); *James v. B. F. Butler Co-op. Bank*, 254 Mass. 82, 149 N.E. 657 (1925); *Government Employees' Credit Union v. Jaquez*, 318 S.W.2d 134 (Tex. Civ. App. 1958).

Membership Rights and Liabilities: See *Massa v. Columbus Credit Union*, 168 A.2d 148 (R.I. 1961).

Nature and Status in General: See *Leach v. Price*, 168 Ohio St. 499, 156 N.E.2d 316 (1959); *Van Pelt v. P. & L. Fed. Credit Union*, 282 S.W.2d 794 (Tenn. App. W.S. 1955).

Powers, Rights and Liabilities of Associations in General: See *King Edward Employees' Fed. Credit Union v. Travelers Indem. Co.*, 206 F.2d 726 (5th Cir. 1953).

Rights and Liabilities as to Persons Not Members or Borrowers: See *Rotterdam Credit Union v. Howell*, 203 N.Y.S.2d 488 (Co. Ct. 1960); *House v. Schwartz*, 188 N.Y.S.2d 308 (Co. Ct. 1959).

5. A private, mutual organization which makes loans to build, buy, or repair houses and is thus limited to investing in the mortgage market. It funds such operations through money received as an investment. These organizations have their own central reserve system in the twelve Federal Home Loan Banks and are subject to control by both state and federal laws.

6. An institution incorporated with power to receive the money of others on general deposit, to form a joint fund that shall be used by the institution, for its

prospective developments should cause increased attorney contact with credit unions. First, the necessity for statutory revision and enactment as re-analysis of the credit union system suggests the need for more effective regulatory control. Second, the growing number of credit unions and members will engage more of the bar in assisting with the organization of a credit union, and in providing counsel to those in existence.<sup>8</sup>

Despite the impression this growth has made upon an increasing segment of the public and the bar, there is an amazing lack of familiarity with and misunderstanding of the credit union concept. This ignorance is manifest in the problematic state of the present credit union system. Generally, the undesirable situation is attributable to the social and economic changes which have occurred since the founding of the first credit union and the failure of the body politic to respond to these changes. The failure to adapt to a changing system has prompted this analysis of the role of the credit union in our economy. This analysis will trace the origin and evolution of the credit union, will present existing problems relating to (1) the adequacy of regulatory control, (2) the prospect and justification of a federal central credit system comparable to the central bank system, (3) the advisability of share insurance for protection of members, and (4) the justification for continued tax exemption, and will make some conclusionary recommendations.

## I. THE ORIGIN AND DEVELOPMENT OF THE CREDIT UNION

### A. *The Nature of Its Creation*

In the mid-nineteenth century, the European economy was confronted with an acute condition. Famine was abroad and peasants, when able to get credit at all, obtained it from the usurer. In 1849, an initial credit union was formed in Flammersfield, Germany, with its purpose the alleviation of the small farmer's plight. This effort consisted of the agriculture community's pledge of their collective earning ability and property in return for a loan which was then reloaned under the administration of the community group. In 1869, a transition was undertaken from this early organization to that of a

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own benefit, to make temporary loans and discounts; of dealing in notes, bills or exchange, coin, credit, and the remission of money. Unlike saving and loan associations, commercial banks may make loans for any purpose, service checking accounts, and operate trust departments. A unique feature of the commercial bank is the ability to create money through a multiple expansion.

7. GILES, *CREDIT FOR THE MILLIONS* 24 (1951).

8. An excellent source to guide such counsel as to mechanical problems is BRIDEWELL, *CREDIT UNIONS* (3d ed. 1962).

cooperative based exclusively on self-help. Due to the ignorant, distrustful, and poverty-stricken state of the membership, progress was slow. However, by 1910 there were 14,993 Raiffeisen banks in Germany with a membership of 1,447,766 and total outstanding loans of 452,749,961 dollars.<sup>9</sup>

The credit union's early struggle was not confined to agriculture alone, for in 1850 a plan directed toward the wage earner in the city was initiated in Eilenberg, Germany. Founded upon the self-help principle, this plan was known as the Schulze-Delitsch system. By 1911, there were slightly less than 500,000 members with total loans for that year of 1,106,165,207 dollars.<sup>10</sup> Inherent in these two systems were differing concepts. Under the Schulze-Delitsch approach, an attempt was made to preclude from membership those persons with no assets or small income—a materialistic concept; while under the Raiffeisen plan, the approach was to welcome anyone whose character was vouched for by a neighbor, even if without assets—a humanitarian concept.<sup>11</sup> An appreciation of the features of the two original systems is necessary as they bear directly on the points of difference that were incorporated into the laws of the individual states of the United States.<sup>12</sup>

### B. *Economic Evolution*

The economic and social circumstances which prompted the spread of the credit union remained unaltered from those that induced its birth.<sup>13</sup> By the end of the nineteenth century credit union development had almost blanketed Europe. North America had been reached; first Canada in 1900 and then the United States. It was for the United States, however, to depart from the early principles of the movement. A credit union is generally defined as a group of people united by common bond, who save money together for the purpose of being able to make loans among themselves for established purposes at low interest rates.<sup>14</sup> Initially, this common bond was confined to parish, or community groups. However, in the United States the social aspect was somewhat weakened as the credit union proved itself so admirably suited to the needs of urban employee

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9. BERGENGREN, *COOPERATIVE BANKING* 46 (1923).

10. HERRICK & INGALLS, *RURAL CREDITS* 73 (1919).

11. HAM, *CREDIT UNION PRIMER* 4 (1930).

12. See Mass. Gen. Laws ch. 419 (1909); N.C. Gen. Laws ch. 115 (1915).

13. See text at p. 207 *supra*.

14. See note 7 *supra*.

groups.<sup>15</sup> Also, it was for the United States to supplement the original remedial loan function of the credit union by recognizing a need for an agency not only "for the loaning of money for those who need to borrow" but also "for the stimulation of thrift."<sup>16</sup> Massachusetts incorporated this view of the economic value into the initial United States credit union legislation in 1909.<sup>17</sup> The thrift facet quickly became of equal significance as credit unions sought to acquire additional funds. It was recognized that under the twofold aspect of the Massachusetts plan, the non-debtor savers could substantially contribute to the available funds. Thus, three new sources of funds, *i.e.*, the hoarder, the prudent conserver, and the speculator, were subjected to the credit union overtures.

Initially the credit unions met competition for their dollars only from the postal savings plan and the mutual savings banks.<sup>18</sup> As the emphasis shifted from remedial to competitive limits, the market for savings competition broadened to other "over the counter" financial institutions such as savings departments of commercial banks and savings and loan associations.<sup>19</sup> However, as intrinsic confines of the

15. INTERNATIONAL CREDIT UNION YEARBOOK 8, chart No. 6 (1963):

Source of Common Bond.

	U.S.	Canada	Elsewhere
<i>Church</i> : members of the same religious group	6.42%	8.76%	15.02%
<i>Residential</i> : people living in the same community	3.07	48.28	41.97
<i>Manufacturing</i> : industrial employees	32.48	16.27	8.63
<i>Educational</i> : teachers, students and school employees	6.93	1.10	1.64
<i>Labor</i> : members of the same union	4.98	2.34	.44
<i>Other Associations</i> : co-ops, lodges, social, farm, and veterans groups	5.58	4.04	11.61
<i>Government</i> : National, state or provincial, or local gov't. emp'y.	13.58	4.98	7.89
<i>Transportation and Utility</i> : communication and utility employees	9.89	4.26	3.57
<i>Food Processing</i> : meat, dairy, canning, preserving, banking employees	5.15	2.98	2.23
<i>Trade</i> : wholesale and retail business employees	5.30	1.62	3.43
<i>Other Occupations</i> : mining, construction, scientific, professional, finance, recreation, and other employees	6.62	5.37	3.57

16. Jay, *1909 Report of the Bank Commissioner*, in BERGENGREN, *COOPERATIVE BANKING* 54-55 (1923).

17. See Mass. Gen. Laws ch. 419, § 1 (1909).

18. See HAM, *CREDIT UNION PRIMER* 16 (1930).

19. Address by Walter Polner, *Savers and Savings in The Credit Union Movement*, CUES Conference on Research Techniques, September 24, 1962.

credit unions were removed, they were replaced by the restraint of a depressed economy. This situation precluded a noticeable increase in the assets-to-member ratio. The consequent effect was somewhat misleading in that the economy distorted the ratio as a growth indicator due to both lack of economic sources and an increase in nominal membership.<sup>20</sup> During the subsequent years, the alleviation of economic stress allowed a truer reflection of the evolutionary role the credit union had attained. Perhaps a more correct statement would be as to the evolutionary role of the credit union in an evolutionary economy, for during the period in which the credit union had altered its course, other instrumentalities of finance had altered theirs. Banks began to engage in loans to the wage earner on an installment basis, savings and loan associations became an increasing source of real estate finance, and federal legislation through the early 1930's provided a source of funds for the small farmer.<sup>21</sup> Not only did the provision of such credit extend into the area for which credit unions were created, but the creditors were becoming competitors for the investment dollar of the wage earner.

During this period the Credit Union National Association (CUNA) was founded.<sup>22</sup> As a non-profit, self-supporting organization of credit unions, its purpose was to more effectively pursue the goals of the credit union concept through a coordinated effort. Through CUNA the credit unions increased their expenditures for attracting members. Abetted by the upswing of the economy, and the resultant increase in wage to an increased number of wage-earners, a new experience awaited credit unions, *i.e.*, attempting to invest a surplus of non-earning assets. The ensuing search by the credit unions for additional borrowers loosened the common bond<sup>23</sup> which had existed previously among their members.

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20. See ROSTOW, *PLANNING FOR FREEDOM* 322-29 (1959).

21. Farm Credit Act of 1933, 48 Stat. 257.

22. See *INTERNATIONAL CREDIT UNION YEARBOOK* 23 (1963).

23. It is the current position of the American Bankers Association that credit unions generally are chartered and supervised to protect only the interests of members—not the public at large as are savings and commercial banks and certain other financial institutions. Thus, a credit union, or any group of credit unions in a given area, should not have the authority to serve the public at large, or large segments thereof. Such position takes issue with the current federal statute which defines a common bond as a group, or groups "within a well defined neighborhood, community, or rural district." The Association recommended that chapter 14, title 12, section 1759 be amended to read that "Federal Credit Union membership shall be limited to groups having a common bond of . . . (a) Employment within an individual plant, office, or firm or (b) affiliation with a local religious or fraternal organization; in all cases coupled with an environment affording an opportunity for personal acquaintance and frequent personal relationship with each other. . . ."

## II. CREDIT UNION PROBLEMS

### A. Regulation

As the credit unions expanded their role in the economy, they were regarded with increasing apprehension.<sup>24</sup> Initial concern centered on a regulatory means of control.

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24. Typical of such apprehension would be the series of events that recently took place within the United States Department of Agriculture. Secretary's Memorandum # 1485, *Policy With Respect To Establishment of Credit Union and Similar Types of Cooperatives*, January 5, 1962, stated in part: "Since the basic purpose of rural credit unions is to be of financial assistance to rural areas and since many of the economic development objectives of the rural areas are dependent upon financial assistance, I am asking the Director of Agricultural Credit to take appropriate steps to assure the full utilization of the institution of rural credit unions in the rural areas development program. Orville Freeman, Secretary." Coupled with this memorandum was a reported request by CUNA for a grant of \$540,000 from the Rural Areas Development program to help organize and promote rural credit unions. Too, there was the rumored plan of the United States Department of Agriculture and CUNA to promote credit unions through REA which now does business with 20,000,000 people. Through REA, credit unions could serve the public at large much as do banks, but without bank chartering and supervisory disciplines. The reaction of the banking profession necessitated a March 5, 1962, meeting between representatives of the United States Department of Agriculture and the American Bankers Association. In a letter stating the position of the American Bankers Association, it was related that in its judgment it could not be proved that promotion of rural credit unions would improve credit services to rural areas. A wide variety of competitive private and government sponsored agencies were referred to as already existent—13,000 commercial banks, 494 production credit associations, 817 Federal Land Bank Associations, 1,450 Farmers Home Administration offices, and 1,000 Rural Electrification Administration Cooperatives; not to mention innumerable insurance company offices, farm equipment dealers, feed companies, private individuals and others; that with due regard for their existence, the American Bankers Association strongly opposed Memorandum # 1485 for three basic reasons. "1. Promoting rural credit unions is not in the best interest of rural areas. It would create too many financial institutions thereby impairing the ability of country banks to grow and attain the size needed to serve most effectively. It would largely negate the good work of various bank supervisory agencies who have diligently worked for many decades to obtain a sound financial community. 2. Promoting one financial institution at the expense of others is unfair. We simply cannot understand by what right USDA would presume to do this, especially in view of the tax exempt status of credit unions. 3. Promoting credit unions would take business from institutions paying their fair share of taxes thus work against the Administration's goal to balance the budget."

On March 8, 1962, this letter was sent to the Honorable John A. Baker, Director, Agricultural Credit Services, United States Department of Agriculture and the Honorable William L. Bott, Jr., Administrator, Area Redevelopment Administration, Department of Commerce. As a result of this letter and supplemental activities, Memorandum # 1485 was revised on July 27, 1962 to read: "Appropriate steps shall therefore be taken to assure the full utilization of *all* types of private credit institutions such as banks, insurance companies, credit unions and individual investors, as well as the various institutions of the cooperative farm credit system, in the rural areas development.

Although naturally the American Bankers Association felt victorious, a news item in the Rural Areas Development Newsletter 4 (February 1964), indicates that CUNA is far from hoisting a white flag. It was as follows: "J. Orrin Shipe, Madison, Wisconsin, and B. C. Webb, Greensboro, North Carolina were appointed new members of the Rural Areas Development Advisory Committee in mid-January. . . . Mr. Shipe is a managing director of Credit Union National Association (CUNA) and its affiliate,

1. *State.*—The initial effort toward enabling legislation occurred within the domain of the states.<sup>25</sup> The original enabling acts had a degree of uniformity due to the manner in which they originated: Edward A. Filene's conducting of a missionary movement through various states.<sup>26</sup> This zealous canvassing of the states was continued under an official organization created for that purpose in 1921—the Credit Union National Extension Bureau. The relative ease with which its efforts achieved success is attributable to the initially slight role of the credit union and its public recognition as a tool with which to combat usury. That the majority of enabling acts were passed within an incredibly short period attests to the success as well as the simplicity of the original credit union program. Characteristic of these laws were regulation of the credit unions' creation,<sup>27</sup> membership,<sup>28</sup> supervision,<sup>29</sup> and financial aspects.<sup>30</sup>

With rare exception there was no provision for maximum loans, maximum loan without security, maximum value of shares which one member could hold, maximum deposit by one person, and a dividend limitation.

In light of the minimal function of the early credit union, the lack of comprehensive enactment was not disturbing. However, in the vast majority of states which passed enabling acts in the embryonic

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CUNA Supply Cooperative and the International Credit Union Movements Chief Executive. The movement embraces 29,000 credit unions serving 17 million members, many of them in rural areas."

25. As of 1962 there were but six states without an enabling act: Alaska, Delaware, Hawaii, Nevada, South Dakota, and Wyoming.

26. GILES, CREDIT FOR THE MILLIONS 92-107 (1951).

27. For example: (1) that a charter issue upon application of seven or more residents; (2) if par value of the shares was set, the figure was generally \$10; (3) that there be a minimal number of 5 directors, 3 supervisory committee members, and 3 credit committee members.

28. *E.g.*, that admission to membership be by election and limited to groups having a common bond of occupation or association, or to groups within a well defined neighborhood, community, or rural district.

29. Supervision of the program is generally placed under either the superintendent of banks, or the superintendent of insurance; this supervisory authority is exercised through (a) annual reports, (b) annual examinations, (c) charter revocation for prolonged unauthorized practices.

30. Some standard characteristics are: (1) that the interest rate on loans should not exceed 1% per month of the unpaid balance; (2) that directors and committee members were to be precluded from borrowing in excess of their share and deposit balance; such provision being applicable to endorsement as well; (3) that the credit union may secure funds by loan from any source and give its note therefor, provided that such borrowing shall not at any time exceed 5% of its assets; (4) that funds of the credit union could be invested other than in loans to members, in state and national banks and, to an extent not in excess of 25% of its capital, invested in shares of building and loan associations and of other credit unions; to also invest in any investment legal for savings or for trust funds in the state; (5) that a reserve fund be created by transferring a percentage of net earnings before dividends to such a reserve until the fund is equal to a percentage of paid capital, total assets, or outstanding loans.

stage of the movement, there has been but minor, if any, re-evaluation of the problem. Those states which have introduced a contemporaneity into their statutes have evidently done so with due regard to the exemplary federal legislation.<sup>31</sup>

2. *Federal.*—The Federal Credit Union Act was passed in 1934.<sup>32</sup> Initially, supervision of federal credit unions was placed in the Farm Credit Administration. In the mid-1940's, this function was shifted to the Federal Deposit Insurance Corporation<sup>33</sup> and finally to the Department of Health and Interior under which a Bureau of Federal Credit Unions was established.<sup>34</sup> Illustrative of the cross current in both economic and political thinking of the time, the federal mechanism was minimal and specifically addressed to ensuring adequate fiduciary safeguards.<sup>35</sup> However minimal this enactment may now seem, the disparity between it and the earlier state efforts was significant.

Other than federal efforts and the minor revisions among the forty-four states with enabling acts of their own, any commendable effort toward effective control and regulation of the credit union has been precipitated by substantially adverse experience under existing law. New York and Massachusetts exemplify this responsive approach to effective regulation.<sup>36</sup> Being subjected to multiple failures and member losses, both states have attempted problem analysis and legislative reform. Their efforts are not of mere academic significance for they provide practical examples from which other states may draft preventive measures. In addition to improved provisions, certain of this legislation encompasses supplemental programs to assist the stability of the overall credit union system, *e.g.*, central credit agencies and share insurance.

### B. Central Credit Systems

The efforts of some states to emulate certain characteristics common to a central bank have provided guidance not only to other states, but have also substantially affected the prospective creation of a central system comparable to our central bank system under the Federal Reserve.<sup>37</sup> Many cooperative finance experts have advocated the establishment of central credit societies to supplement the work of

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31. Federal Credit Union Act, 48 Stat. 1216 (1934), 12 U.S.C. § 1751 (1958).

32. *Ibid.*

33. 61 Stat. 952 (1947).

34. 62 Stat. 1092 (1948).

35. *Hearings Before the Subcommittee on Federal Credit Unions of the Senate Committee on Banking and Currency*, 73d Cong., 2d Sess. 13-31 (1933).

36. See MASS. ANN. LAWS ch. 171, § 22 (1959); N.Y. BANKING LAW §§ 450-80.

37. 38 Stat. 251 (1913).

local credit unions.<sup>38</sup> A central credit society is generally defined as a financial institution incorporated under federal legislation, which serves credit unions on a national scale.<sup>39</sup> The Federal Credit Union Act, as originally submitted, made an effort in this direction by providing for statewide central credit societies composed both of state chartered and federal chartered credit unions.<sup>40</sup> However, this section was dropped from the bill prior to its enactment. A revival and supplementation of the original provision for a central credit society occurred in 1953, when CUNA drafted a bill which was introduced in the second session of the Eighty-Third Congress.<sup>41</sup> The bill would have erected a structure of from six to twelve regional credit union districts. The operational details of the system were to be supplied by the Director of the Bureau of Federal Credit Unions. The organizational provisions were the familiar ones of the Federal Credit Union Act with only nominal variances: (1) shares of stock would have a par value of 100 dollars; (2) members would have to subscribe to at least 2 per cent of their membership holdings; and (3) it would be required that at least fifty credit unions subscribe to the organization certificate and pledge at least 250,000 dollars.

It is contended that such provisions would establish a reliable source of funds for local credit unions when in need of borrowing accommodations.<sup>42</sup> Should tight money conditions again prevail for a prolonged period, finding local credit unions with frozen loans, it cannot be denied that the rediscount service of a regional credit society would be welcome. Critics of the plan seemed to have two fears: first, that the establishment of regional credit union societies would validate and further extend the encroachment of the credit union into the general banking business,<sup>43</sup> and second, that the regional rediscount services would fail to fare any better than had state central credit agencies when confronted with rediscount requests and only token resources from which to respond.<sup>44</sup> The former criticism arose from the confused attempt to reconcile the central credit society espoused by the act with the traditional concept of a

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38. See note 6 *supra*.

39. U.S. BUREAU OF FEDERAL CREDIT UNIONS, A STUDY OF THE NATURE AND ROLE OF CENTRAL CREDIT UNIONS AND OF THE DESIRABILITY OF PROVIDING FOR FEDERALLY-CHARTERED CENTRAL CREDIT UNIONS 4 (1960).

40. See S. 1639, 73d Cong., 2d Sess. (1934).

41. S. 2890, 83d Cong., 2d Sess. (1954).

42. CROTEAU, FEDERAL CREDIT UNION 179-80 (1956).

43. See United States Investor, *What About Credit Unions? Rapid Increase in the Number of Them Raises Some Confusing Issues*, August, 1954; W. B. French, *The Rapid Growth of Credit Unions*, J. Banking, July, 1954, p. 3.

44. U.S. BUREAU OF FEDERAL CREDIT UNIONS, A STUDY OF THE NATURE AND ROLE OF CENTRAL CREDIT UNIONS AND OF THE DESIRABILITY OF PROVIDING FOR FEDERALLY-CHARTERED CENTRAL UNIONS 22 (1960).

central credit society whose economic functions are not only the maintenance of a liquid position among its member societies, but also accumulation of funds, both from cooperative sources and the general public; channeling of funds into cooperative undertakings; and other service functions such as clearing house operations, trustee functions, auditing services, and the custody of securities.<sup>45</sup>

This criticism was mollified by the express language of the act which stated "that nothing in this act shall be construed to authorize a regional credit union to enter into the general banking business."<sup>46</sup> The validity of the criticism that the past inadequacies of the state central credit societies would attach to the proposed federal system requires an analysis of the proposed statute. Although the permanent financing of the Federal Central Credit Society would have consisted of stock subscriptions from participating credit unions, these funds would have been non-withdrawable.<sup>47</sup> However, the additional funds derived from deposits of individual credit unions would have been withdrawable according to established rules and regulations.<sup>48</sup> More important was the power of the Central to borrow and to issue securities for sale either to the general public or through private placement.<sup>49</sup> The latter provision and its successful experience in funding other governmentally assisted lending programs would seem to weaken this second criticism.<sup>50</sup> It appears significant to note that Congress provided in the original Federal Credit Union Act section 7(9), that "any federal credit union may discount with or sell to any federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital . . ."<sup>51</sup> Eligible paper was confined to agricultural paper,<sup>52</sup> but such limitation qualified any substantial benefit, for federal credit unions provide the bulk of their service to industrial and commercial groups.

These merits were never debated on the floor of Congress for opposition to the bill prevented its report from committee. Subsequent attempts at legislation in 1956 purported to authorize the organization of federal central credit unions and to permit them to invest in shares of state central credit unions.<sup>53</sup> Again the bills were not reported from committee. Some twenty bills were introduced in

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45. BAROU, CO-OPERATIVE BANKING 258-73 (1932).

46. S. 2890, 83d Cong., 2d Sess. (1954).

47. *Ibid.*

48. *Ibid.*

49. *Ibid.*

50. Farm Credit Act of 1933, § 37, 48 Stat. 257.

51. Federal Credit Union Act § 7(9), 48 Stat. 1218 (1934).

52. See note 44 *supra*.

53. S. 3539, 84th Cong., 2d Sess. (1956); H.R. 8273, 84th Cong., 2d Sess. (1956); H.R. 10832, 84th Cong., 2d Sess. (1956).

the Eighty-Sixth Congress for the purpose of amending the Federal Credit Union Act. Among these were proposals to authorize the organization of federal credit unions and to permit federal credit unions to invest in shares of central credit unions. The House Ways and Means Committee, in reporting the bill, noted that opponents to the provision for central credit unions were the Bureau of Federal Credit Unions, the Treasury Department, and the Federal Reserve Board; that the sole proponent was CUNA.<sup>54</sup> Accordingly, Public Law 86-354 did not include these two proposals but did require that a study and report be made by the Director of the Bureau of Federal Credit Unions to Congress on the desirability of providing for federally chartered central credit unions.<sup>55</sup> The report was made on June 10, 1960.<sup>56</sup> The essence of the report was a recognition of the inadequacy of status quo, but it also recognized the lack of acceptable alternatives.<sup>57</sup> The study further noted that patterns of interlending have developed between the local credit unions through direct negotiation as well as through some thirty-one state central credit agencies.<sup>58</sup> Although the experience of properly staffed and regulated credit unions was admittedly good, the loss ratios low, the Bureau quickly qualified this success by further noting that the contemporaneous system has not been put to any test of economic consequence.<sup>59</sup> It was concluded that the central credit unions such as those now chartered under state laws, would be ineffective in meeting existing liquidity problems and even more ineffective as to future problems. Consequently, there was a recommendation against federal chartering of such organizations, or authorization of investment of the funds of a federal credit union in shares of a state-chartered central credit union.<sup>60</sup>

### C. Share Insurance

The role of insurance in the credit union system has been confined to (1) bonding coverage to protect the credit union against possible losses through defalcation, and (2) life insurance.

Early in the development of the state systems, the state supervisors sporadically prescribed bonding procedures for credit unions solely on the basis of their membership in the general fiduciary family.

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54. H.R. 8305, 86th Cong., 1st. Sess. (1959).

55. 73 Stat. 639 (1959), 12 U.S.C. § 1752a (Supp. IV, 1961).

56. U.S. BUREAU OF FEDERAL CREDIT UNIONS, A STUDY OF THE NATURE AND ROLE OF CENTRAL CREDIT UNIONS AND OF THE DESIRABILITY OF PROVIDING FOR FEDERALLY-CHARTERED CENTRAL CREDIT UNIONS (1960).

57. *Id.* at 21, 22.

58. *Id.* at 9-13.

59. *Id.* at 21.

60. *Id.* at 21, 22.

Federal supervision was limited to suggesting minimum bond coverage. The protection of the credit union was left wholly to the discretion of its directors. However, due to serious credit union defalcations in the early 1950's, an amendment to the Federal Credit Union Act enacted into law in 1954 granted authority to the Director of the Bureau of Federal Credit Unions to prescribe minimum bonding coverage and the form of contract; the primary responsibility for the amount of coverage remaining with the credit union's board of directors.<sup>61</sup>

As to life insurance, most credit unions now provide coverage based on the amounts the member saves and borrows. Such provisions are addressed to two problems; the general need of members for additional insurance coverage, and the satisfaction of an unpaid balance in the circumstances of a debtor's death. The principal movant in so firmly establishing this use of insurance has been the CUNA Mutual Insurance Society.<sup>62</sup>

Share insurance has been advocated to safeguard credit unions against additional contingencies. In 1947, a bill was unsuccessfully introduced to insure the shares of federal credit unions with the Federal Deposit Insurance Corporation.<sup>63</sup> A 1955 consideration of share insurance by the Counsel of Economic Advisers gave more breadth to this suggested program by proposing a mandatory membership for federally chartered unions and a voluntary membership for those having state charters.<sup>64</sup> The major obstacle to legislation on the matter was and is CUNA. It considers the value of share insurance as restricted to psychological significance. The alleged disadvantages against this significant advantage are: (1) the hindrance to new organizations; (2) the increase of liquidations since shareholders would be re-imbursed only if the credit union were liquidated; (3) the failure of marginal credit unions to qualify; and (4) the accompanying restrictions on lending practices through additional emphasis on safety.<sup>65</sup>

Additional reasons offered are fears that the cost of share insurance might not be absorbed without reduction in dividends<sup>66</sup> and that share insurance might give federal credit unions a competitive advantage over state chartered systems.<sup>67</sup>

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61. 68 Stat. 792 (1954).

62. INTERNATIONAL CREDIT UNION YEARBOOK 16 (1963).

63. The ill-fated "Rains Bill" designed to insure the shares of Federal Credit Unions with the F.D.I.C.

64. Economic Report of the President, H. Doc. No. 31, 84th Cong., 1st Sess. (1955).

65. CROTEAU, FEDERAL CREDIT UNION 166 (1956).

66. U.S. BUREAU OF FEDERAL CREDIT UNIONS, INSURANCE OF SHAREHOLDINGS IN FEDERAL CREDIT UNIONS (1953).

67. *Ibid.*

#### D. Tax Exempt Status

The cooperative nature of the credit union was instrumental in securing its initial tax exemption. An additional consideration was a desire to attract more funds to consumer lending. A thread running through the justification of continuing exemption has been a premise that public policy assigns a higher order of social priority to some uses of credit than to others. This premise is further substantiated by the economic history of this country manifesting greater wisdom in allowing credit to flow freely into areas where it is in the greatest demand and can be used more profitably.<sup>68</sup>

The federal statute presently exempts the property, franchise, capital, reserves, surplus, other funds, and income of credit unions formed under the federal statute from all taxation imposed by federal, state, territorial, or local taxing authorities; excepting any real property and tangible personal property which shall be subject to federal, state, territorial, and local taxation to the same extent as other similar property is taxed.<sup>69</sup>

The states have generally allowed taxation of state credit unions only as to real estate owned, a franchise, and an excise tax; the shares in the credit union not being subject to taxation or to a stock transfer tax either when issued by the corporation, or transferred between members.

#### III. RECOMMENDATIONS

Each of these four problem areas of the credit union system have a common conflict which must be resolved before effective solutions can be derived for any. This conflict concerns the role of the credit union in our economy. The difficulty in reaching a solution is emphasized by the realization that the arguments of both the advocates of an enlarged role for the credit union and the opponents, who would legislate not only to control future growth but also to cause a present reversal of such growth, are permeated with inconsistencies. While claiming their right to a substantial voice in the financial community and a correlative financial structure therein, *i.e.*, a central credit system, the credit unions have undermined the stature of their claim for such a voice by seeking special privileges in the form of continuing tax exemptions, slack regulatory controls, and by neglecting share insurance. Opponents have been no less insensible in maintaining an ostrich attitude of utter disregard for the established and prominent status currently enjoyed by the credit

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68. This is the view espoused by William F. Kelly, President, American Bankers Association.

69. 51 Stat. 4 (1937), 12 U.S.C. § 1768 (1958).

union.<sup>70</sup> The lack of realism in such attitude is further compounded by an attempt to subject the credit union to more stringent regulation and taxation based upon the significant public position to which the credit union has evolved and the inconsistent contention that the credit union has but a limited role in the financial community which can be properly maintained in a bastardized status, as opposed to the independence obtained through a Federal Central Credit System. A recommended course is for the financial community to accept the credit union as an existing component in the overall financial machinery of the nation and for the credit union to discontinue its attempt to portray the paradoxical role of a member of the financial community but one in need of special treatment. Although the criticism that the credit union has gone beyond its original bounds is well founded,<sup>71</sup> it is capably met by the counter opposition that like changes have occurred throughout an awakening financial community.

Once a realistic attitude is assumed and a consequent acceptance accorded credit unions, the fear of enhancing the system by appropriate legislation will be minimized. That the status quo as to economic control of the national economy is inadequate is well recognized; an inability to control investment increase due to the lack of control over and continuing growth of non-bank intermediaries must be recognized and acted upon. Although an investment increase in the economy may be a more desirable form of economic stimulus due to the leverage effect it has upon all forms of economic activities, it is to be noted that an outburst of consumer spending is apparently as stimulating as the "trickle down" of economic activity from the investment dollar.<sup>72</sup> A sudden burst of consumer expenditure financed by hitherto idle hoards, could have a similar, although lesser, expansionist effect to an increase in investment spending financed with newly created bank loans. The question then is not whether a central credit system is desirable and necessary, but rather how it is to be

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70. See generally, Statement of Polley on Credit Unions, American Bankers Association (April 18, 1959) which regards the credit union movement as if it were in that embryonic stage of the early 1930s, when talk of a common bond could be in terms of present rather than past tense.

71. Mr. Walter Polner, Director, Research, Economics and Statistics Department, Credit Union National Association, in an address to the Thomas W. Doig Chapter of the Illinois Credit Union League in Waukegan, Illinois on October 18, 1962 confessed as much when in an enviable moment of caustic frankness he said: "Let us not make the same mistakes the banks made. Let us not be too self-satisfied like the banks were. Let us not do like the banks. If we do not provide the services that our members desire, some other institutions will. Now is the time for the credit unions to determine that they will not commit the same errors that were made by the self-satisfied banks."

72. ROSTOW, *PLANNING FOR FREEDOM* (1959).

created and by whom it should be administered. Although the Federal Government has not been adverse to creating an independent facility to coordinate the activity of cooperatives,<sup>73</sup> its functions are not so dissimilar to those of banking as to disallow effective annexation by the Federal Reserve System. As the control agent over the prime source of present credit for credit unions, *i.e.*, commercial banking, the Federal Reserve System offers a coordination of the two under a single agency.<sup>74</sup> A structure fully independent of the Federal Reserve System has been proposed in a bill calling for the creation of a Federal National Credit Union Fund Corporation.<sup>75</sup> The capital of the corporation would be composed of shares held by member credit unions. In addition to members credit union deposits, additional funds would be obtained through an authorized borrowing from the Government as well as the sale of tax exempt obligations in the open market. In turn, the corporation would lend money to the member credit unions, purchase their notes and receivables, and assist them in conducting an inter-lending program. Although the immediate reaction from other members of the financial community has been one of opposition to what is considered as the credit unions' bid for a banking system of their own, a recommended course would be the seizure of this opportunity to package a compromise which would weigh greatly in the public's interest. Contained within the compromise would be share insurance previously opposed by CUNA, who have been unable to perceive a sufficient counter balance in the psychological advantage of such insurance to the disadvantages of a more stringent regulatory con-

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73. Farm Credit Act of 1933, 48 Stat. 257.

74. However, with the current chairman of the House Banking and Currency Committee, the Honorable Wright Patman of Texas, it would be sheer folly to suggest the origin of any legislation which would smack of a strengthening of the Federal Reserve System. See generally Dukes, *The Oddball Crusade of Congressman Patman*, Saturday Evening Post, March 7, 1964, p. 62.

75. The bill was drafted by Charles P. Seibold of Aberg, Bell, Blake and Metzner, of Madison, Wisconsin and, as reported in 7 Report on Credit Unions No. 3, 18 (March 15, 1964), would provide, in part, for the creation of a Federal National Credit Union Fund Corporation. This corporation, to be composed of every insured credit union, will make loans to, accept deposits from, and otherwise aid insured credit unions. Insured credit unions may join this corporation for an amount equal to 1% of the credit union's insured accounts. The fund created by these membership moneys shall be administered by a five man board appointed by the President of the United States. The debt securities of this corporation shall be tax exempt both as to principal and interest. The activities of this corporation will be coordinated with those of the Bureau of Federal Credit Unions and the Share Insurance Corporation.

Mr. Seibold has drafted a similar statute to provide for a Federal Credit Union Share Insurance Corporation to be administered by the board of the Federal National Credit Union Fund Corporation. This statute would automatically insure every federal credit union and be available to any eligible state credit union desiring to participate. Other sections of this statute provide for assistance to member credit unions and for the correlation of this corporation's activities with those mentioned above.

trol which accompanies it.<sup>76</sup> These regulatory disadvantages have been particularly unattractive to marginal units, but are not inconsistent with the sacrifice made by any substantial member of the financial community. Also included within the compromise would be a question as to the continued tax exemption of the credit union. Although the initial exemption may have been justified, the competitive nature of the movement hardly justifies its continuance. The process of such compromise will not be unlike the present difficulty CUNA is experiencing between its members who favor and those who disfavor share insurance. A reconciliation seems possible only through a compromise which would tie a bill creating share insurance to one creating a Federal Central Credit System.<sup>77</sup> Likewise, the reconciliation of the banking and credit union interest will be obtained only through the realistic vehicle of compromise.

CHARLES D. MATTHEWS

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76. See text at p. 217 *supra*.

77. See 7 Report on Credit Unions No. 3, 17 (March 15, 1964).