CREDIT UNIONS, MUTUALS AND BANKS

by Steve Brown

After handing over a debit card at the checkout stand at the grocery store the other day, the checker said, "Oh, I go to a credit union!" We smiled and asked the checker if they knew credit unions didn't yet pay taxes and whether that still made sense when the government was so hurting for revenue. The checker stared back in stunned silence and then pondered the question as they swept a can of soup over the reader and waited for the beep. After completing the process and paying for everything, the checker asked if that was really true and when we told them yes it was, they just shook their head. The age old discussion between banks and credit unions (CUs) around taxes wages on and we have to say CUs have done a marvelous job of positioning themselves as community-minded providers of service. Community banks have been left behind in this propaganda battle in many cases. Now CUs are lobbying to increase the cap limit on commercial lending from 12.25% to 27.50% of assets for well capitalized institutions. We are true believers in fair competition for all and love this country for it, but we don't get the exemption in this day and age. It got us thinking about the history of the tax status, so we did some research. Some time ago, there were basically two kinds of institutions created to serve the needs of lower and middle class consumers. At the time mutual savings banks came about (the mid-1880s in the US), traditional banks had little interest in serving the needs of working class individuals and were mostly focused on corporations. Mutual savings banks were primarily in the business of caring for depositors and with their pooled savings, making home mortgage loans to their small group of members. Credit unions were originally designed to provide credit to underserved individuals and especially to provide short- term personal loans Ã¢Â€" often used by labor union members during periods of unemployment. State chartered credit unions were first to be exempted from taxation in 1917. Federally chartered credit unions, through legislation of Congress in 1937, received the same status on the grounds that they resembled cooperative organizations such as mutual savings banks, mutual insurance companies and mutual savings and loans. The congressional action simply made the tax treatment consistent among similar institutions. However, mutual savings banks, mutual insurance companies and mutual S&Ls lost their tax exemptions when they reached a point of "active competition" with taxable institutions. By the 1970s, mutual savings banks were mostly indistinguishable from other banks, offering checking accounts and similar product lines. Most mutual savings banks have since converted into stock- holder owned institutions and other than a handful of mutual savings banks in the northeast, they are fairly rare. CUs too, have evolved into full-service depository institutions over the past 30Ys, with product lines indistinguishable from banks. They also were allowed to broaden their customer bases first in 1982 and the common bond requirement pretty much disappeared with a 1998 law. Until recently, consumer lending was always the primary specialty for most CUs, but now they are active in the commercial lending arena. It seems unlikely that the tax exempt status of CUs will change anytime soon, but perhaps the more banks and CUs look alike the less likely it will remain. As for us, we project it will go away in the next 10Ys, given how close banks, CUs and everything else financial has become.

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PCBB 2013 Executive Management Conference

BANK NEWS

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Heritage Financial ($1.2B, WA) will acquire Valley Community Bancshares ($242mm, WA) for $44.2mm in cash and stock.

M&A

Midland States Bancorp ($1.6B, IL) will acquire the BHC of The First National Bank of Grant Park ($105mm, IL) for an undisclosed sum.

Spooky

A new study finds 76% of college students say they have no idea what happens when they make a late payment on a credit card and 90% don't pay their balances in full.

Women Biz

A study by Web.com finds 81% of women small business owners feel upbeat about their business prospects for 2013 and 93% plan to invest more or the same in hiring as they did last year. As for borrowing, 45% fund growth using credit cards and 40% use earnings from the business.

Expectations

Community banks thinking about either buying or selling should expect among other things a thorough review of: the loan portfolio (usually 80% coverage), audit work (past 3Ys), board minutes (past 3Ys) and a detailed customer review (to determine best clients and profitability).

ID Fraud

According to Javelin Strategy & Research, identify fraud incidents increased 1mm last year to $21B, the highest level since 2009. Overall, 12.6mm people were victims of ID fraud. Further, a compromised Social Security number in a data breach is 500% more likely to result in fraud than the average. Personal information such as online banking login, user name and password were compromised in 10% of cases.

72/28 Rule

A new survey by Advisor Impact finds nearly all customer referrals come from only 28% of so called "engaged" clients and they also normally give multiple referrals. Each person in the referring group provided an average of 2 referrals in the past 12 months (16% provided 3, 4% gave 4 and 5% provided 5 or more).

Accounting

The Public Company Accounting Oversight Board (PCAOB) has publically rebuked PricewaterhouseCoopers, saying the firm failed to remedy serious problems with procedures and "may not be applying an appropriate level of professional skepticism in subjective areas susceptible to management bias." Such public comments are rare and only occur if the PCAOB feels the firm is not doing enough to remediate identified issues.