

Credit unions angry over surprise 'bailout tax'

By Tom Philpott

Federal credit unions, including those serving millions of military patrons, are fighting to keep off their books nearly \$5 billion in charges that regulators have assessed to bail out their largest "corporate" credit union.

The U.S. Central Federal Credit Union was in danger of insolvency due to losses on mortgage-backed securities until regulators adopted a bailout plan Jan. 28 that would be financed by 7900 member-based credit unions.

"If we were to allow something to happen to U.S. Central, the impact on the industry would have been devastating," said Michael E. Fryzel, board chairman of the National Credit Union Administration (NCUA).

But Fred Becker, chief executive for National Association of Federal Credit Unions in Arlington, Va., said NCUA's "premiums" on member credit unions, unless lowered by September when scheduled to take effect, "would drive most of the industry's income into the red" for calendar 2009.

Fryzel conceded that some smaller credit unions have warned that their part of the "bailout tax," as some call it, would leave them undercapitalized, threatening their viability. Fryzel said none of these credit unions serve military populations. In any case, NCUA will "work with them," he said, to ensure the special assessment doesn't have such a dire effect.

Credit union officials say there is no reason for members to fear for their deposits. Individual accounts are insured by the government for up to \$250,000. Military credit unions contacted for this column said they don't even expect the bailout tax to force them to lower member interest rates paid on savings accounts or to raise interest charges for loans or mortgages.

However, other customer services could be affected. That might include, said one official, a smaller workforce to run customer call centers or delays in opening new branches or renovating old ones. Some credit union officers clearly were upset at the NCUA board for deciding on a bailout plan for U.S. Central before discussing alternatives with them.

"We do not believe that the federal agency has a moral and ethical right to steal our members' capital," said Frank Pollock, chief executive of the Pentagon Federal Credit Union. This credit union expects to take a \$44 million hit, losing a third of earnings this year, if the bailout plan stands.

Cutler Dawson, CEO of Navy Federal Credit Union, the largest credit union in the country with 3.2 million members and \$36 billion in assets, called the bailout plan "unacceptable and untenable." Dawson estimates that his credit union would see return on assets fall by \$80 million this year and by a total of \$280 million over three years.

Credit unions are popular alternatives to banks. They are owned, in effect, by their depositors. Without corporate profits or shareholders to worry about, credit unions can offer higher interest rates on savings accounts and charge lower rates for mortgages, auto loans or other financial help.

Because many credit unions are too small to use support services available through the Federal Reserve, the industry decades ago set up a network of corporate credit unions. "Natural-person" credit unions rely on their "corporates" to invest excess capital, as a source of liquidity and to provide check clearing and other payment services. The 23 corporate credit unions, in turn, have their own credit union, U.S. Central Federal.

"Unlike natural-person credit unions that swim in a pretty calm sea, the corporates swim in a rougher sea, which now has turned out to be shark-infested," said Becker. "They got wrapped up like everybody else in the current crisis" by investing in mortgage backed securities that turned bad.

Return on assets, ROA, is the yardstick credit unions use to measure annual performance. A one percent return is a good year and relatively few credit unions will reach it in 2009 just given the deepening recession.

The U.S. Central bailout, as structured, "makes tough times tougher," said Dawson. It would force credit unions to lower their ROA a total of 62 basis points. The portion payable by fall would wipe out any ROA in '09 for some credit unions and cut profits for many others at least by half.

"It means you can't do the things you wanted to do like invest in more branches, give raises to your staff. You can't paint the building. There are just so many things you can't do," said Pat Keith, spokesman for the Credit Union National Association in Washington, D.C.

Fryzel said he and other NCUA board members have heard the complaints, met with credit union associations as well as with Pollock and Dawson, and are working together on alternatives to ease the negative effect of the bailout. Some proposed fixes require legislation including allowing a capital infusion from the Federal Reserve's Central Liquidity Facility. Another option is to ask the Treasury secretary to allow corporate credit unions to use the Troubled Asset Relief Program, the fund behind the banks' bailout.

Many credit unions were surprised by the assessment.

"When they hear why the board had to take the action," Fryzel said, "they are more rational and say, 'Okay, we understand what had to be done and we're looking forward to the board mitigating our losses and cutting the cost to us.' "

"This is not a done deal by any means," said David G. Elliott, chief executive of the Fort Bragg (N.C.) Federal Credit Union, where the bailout would cut return on assets by a total of \$500,000.

"We would look internally to make sure our [53,000] members were not affected," Elliott said. "We are fortunate that we have at Fort Bragg 11 percent capital built up, which is why you build up capital for a rainy day."

Elliott said he doesn't know of any military credit union put at risk by the bailout.

"The military is sort of recession proof with our members because they're going to have jobs. That's the good side of being a military-oriented credit union as opposed to [one serving] General Motors right now," he said.

IF INTERESTED PLEASE SEND THE FOLLOWING LETTER

March 3, 2009

The Honorable Timothy Geithner
Secretary of the Treasury
Main Treasury, 1500 Pennsylvania Ave, NW
Washington, DC 20220

Dear Secretary Geithner:

The Military Coalition, a consortium of nationally prominent military and veterans associations representing more than 5.5 million active duty, Guard, Reserve, retired and former members of the uniformed services, plus their families and survivors, urges your immediate action to ease a significant financial burden being imposed on America's military credit unions by the National Credit Union Administration (NCUA). The NCUA's plan to immediately restore the National Credit Union Share Insurance Fund to its maximum operating level will cause member-owned credit unions to forfeit nearly \$5 billion in order to replenish losses incurred by "corporate" credit unions.

This poses an unfair penalty on military members and families by robbing essential resources from the roughly 90 military credit unions, including some of the world's largest, that provide low-cost financial services to military members and families around the world. Credit unions play a particularly crucial role in the military community by giving hard-pressed families much-needed options for financial literacy and alternatives to usurious payday lenders.

The NCUA's unfair requirement would force almost half of all military credit unions into the red, which would mean degraded services, reduced loan opportunities, reduced savings returns, and higher loan rates for millions of military families who depend on their local credit unions for essential financial services.

I urge you most strongly to use the authority of your office to prevent imposing this unfair burden on blameless credit unions and their military family "owners", who already have had to bear a grossly disproportional

share of national wartime sacrifice. They should not be forced to assume this extra measure of financial sacrifice to bail out other institutions' bad investments.

Sincerely,

The Military Coalition
(Signatures enclosed)

cc:

NCUA Chairman Michael Fryzel
NCUA Vice Chairman Rodney Hood
NCUA Board Member Gigi Hyland