Attachment 3
Testimony of NCUA Chairman Norman E. D'Amours
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The Need for Mergers

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Almost all credit unions are willing to consider mergers but few know how to make them happen. As one community chartered credit union told a colleague, "I can't make the phone ring." Consolidation of the 11,351 credit unions into a smaller number of more effective institutions may be one of the most important steps for credit unions to thrive in the 21st century. Why is this so? How can the cooperative resistance to merging be overcome?

The Banking Consolidation

The much-publicized mega-mergers have made the consolidation of the banking and thrift industry front-page news for the past several years. The driving forces in these changes are many. Regulatory boundaries no longer limit bank charters to a single state or region. Large competitors are the norm in international markets where the largest American banks also seek to grow and serve corporate customers. The drive to achieve scale and cut costs through consolidation has been the logic used to sell these mergers to the financial markets where stock is used to pay for the acquisition.

Banks and thrifts were founded when financial services were viewed as either a local or at best a statewide business activity. These artificial limits imposed by legislative and regulatory rules have been swept away. Some now believe there is tremendous over capacity in depository financial services. Mergers are a way to rationalize the banking system.

However, the consolidation model to achieve competitive advantage has been likened by one observer to the mating of dinosaurs, suggesting that size and scale alone may not be sufficient for survival in the future.

Two Kinds of Mergers Needed

The credit union system, like the banking system, was developed in an era when small was beautiful and local markets were the way all business was conducted. Throughout the latter part of the 20th century many products and services became national in brand and scope as technology, communications and mass marketing ushered in the era of consumerism following WWII. Only in the 1980s did deregulation begin to remove the artificial limits on depository financial services provided primarily by local firms.

While credit unions have dropped from a peak of 24,000 active charters over 20 years ago to less than half that number today, the rationalization of the system has slowed dramatically this decade. Two kinds of mergers are necessary. One is to provide members of the smallest credit unions access to meaningful cooperative alternative. The second is to provide larger credit unions with the resources necessary to compete in the new financial services world still being developed. While we only see the future dimly, we do know that many credit unions are short of the critical skills necessary to compete there.

The Smaller Credit Unions

8,422 credit unions under $20 million comprise 74.2 percent of all credit unions, but only manage 11.5 percent of total assets. These credit unions often lack the resources to provide the minimum range of services necessary to establish a primary financial institution (PFI) relationship with members.

For example, only 45.5 percent of these 8,422 offer share drafts; only 30 percent offer credit cards; fewer than 15 percent offer first mortgage lending and only 10 percent offer home equity loans.

But the issue isn't just kinds of services. The economic value received by these members is significantly less than in credit unions over $50 million in total assets. For example, if the members of credit unions under $20 million received the same dividend rates as paid to members of larger ones, the dividends would raise by $67.3 million. Car loan rates are higher at smaller credit unions. Members would save $97.8 million by borrowing from larger credit unions at their average new car rates.

Smaller credit unions must pay more to cover basic operating costs. The expense ration for smaller credit unions is 45.9 percent of each dollar of income versus only 38.4 percent at larger credit unions. It is costing member at least $131.3 million more just to keep the smaller credit unions operating than to receive a fuller range of services with the better economic value and often in a more professional manner from larger ones.

The result is that many smaller credit unions do not deliver good member value. I recently heard the experience of a person hired from the hotel industry to manage a total quality program at a $400 million credit union. Prior to joining this credit union, she did not believe there was anything special about credit unions. Cleaning out her attic prior to the new job, she found records of five different credit unions she had joined at one time in her career. All were small, open only one or two days a week, and frequently serving only the employees of the hotel where she worked and often serving only part of the employee base.

This class of underserved members does not provide a sure foundation for the future of their own credit union. For example, if the average member share and loan balances at the credit unions under $20 million equaled that of the over $50 million group, then the credit union system as a whole would have $30.6 billion more in savings and $7.9 billion more in loans. The sooner these inequities of service quality can be changed the better off members and the whole movement will be. The quickest and most effective way of making this change for many smaller credit unions is to merge with a larger institution already providing this higher level of service. Both the members and credit union system would be better off.

Getting to the Future Faster

Why should two credit unions who are doing well on their own, offering reasonable value to members and growing, consider joining together? While there will be numerous examples of local advantage from diversifying economic and geographic bases, expanding delivery system capability and finding new economies and cost savings, I believe the core reason is much more critical.

The future of consumer financial services is going to look very different from the brick and mortar model that was basis for most services until this decade. In the networked world of open finance where individuals will have a meaningful choice for any financial service, now delivered by a "local" institution, the scarcest resource for credit unions is management time and talent. Individuals who know and understand not only credit unions as they operate today, but how they must evolve into institutions which manage information for and about members in completely new ways, are hard to find. New models of finance and member service will have to be built. To survive, credit unions will not just manage member loans and insured deposits, but also flows of assets to help members find the best range of insurance, credit and investments options available.

Copying the future is not possible. It must be invented by credit union managers working to apply new technology faster than members who are learning to use the same tools at work or at home. Most managers' time is tied up running the current business. Additional resources are needed to permit the management team to work on the future as well as the present. Those resources are best found in other credit unions.

Merging is in the Public Interest

Accelerating the two kinds of merger opportunities described above would benefit more than individual credit unions and their members. Congress passed HR1151 to help stimulate financial alternatives for the American consumer. In many large cities credit union services are either not available or easily accessed. In cities where credit union service is a meaningful option such as Peori, Illinois; Tampa, Florida; or San Antonio, Texas, this is because there are a number of larger credit unions who compete for business. Credit unions cannot be started up like banks with capital to fill the gaps in communities when the local institutions are bought out. The sooner major cities can have similar credit union service to the three above, the sooner the intent of Congress can be met to assure that consumers have a real choice in how they carry out their financial transactions.

Second, regulatory resources are limited just as are those of every other organization. NCUA has cut back on its exam cycle and hired more examiners to try to keep up with its workload. Fewer credit unions would permit regulatory attention to be more focused, timely and responsive.

Most importantly, larger credit unions working with managers coming together in fewer organizations are much more likely to develop the kind of strategies and models that will keep credit unions alive in the future. Today most of the innovation and breakthrough ideas are from the larger credit unions.

Fewer, stronger and more adaptive credit unions will benefit members, credit union managers, the regulator and the American consumer. Who will be the first to pick up the phone and start the conversation going?

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