

Opinion 96-16 (Redacted version)

November 25, 1996

“A” Credit Union

Subject: Application of “B” Credit Union to include community of “C” in its FOM
Opinion no. 96-16

Dear _____:

This letter is in response to your two comment letters, dated June 12 and August 30, 1996, on the application of B to add the community of C to its field of membership (FOM). Considering the current financial strength of A, with over 10% capital, we have concluded that approval of B’s application does not present an immediate threat to the viability of A under WAC 208-472-075(7).

As we discussed the other day, we have approved B’s application. The following is a list of the major points (some in paraphrase) in your letters, followed by our response.

JUNE 12, 1996 LETTER

1. Comment: The B expansion would constitute “an immediate threat to the viability” of A.

Response: WAC 208-472-075 provides certain criteria that the Division considers when processing FOM applications. The criterion stated in subsection (7) is: “Whether approval of the application might reasonably threaten the viability of another credit union.” In normal usage, the word “threat” denotes some immediacy or urgency. For that reason, the letter sent out by FOM applicants requests comment whether approval will present an immediate threat to another credit union.

The comment letters received from A were the most detailed we have received on this issue to date, and caused us to spend some time sorting through the facts and considering our policies on “immediate threat to viability.”

In considering the issue, we have concluded that the approval must threaten the viability of another credit union within a relatively short time period, such as six months. There is no question that A genuinely believes that approval of B's application will have an adverse financial impact on A. However, there was no indication from your letters that the impact would be immediate. It would seem that a typical scenario for "immediate threat" would involve a credit union that was in a very weak capital position, perhaps a CAMEL 4 or 5. A currently enjoys a very strong capital position, in excess of 10%.

In looking at this issue, we also consulted some of the pertinent studies on credit union competition. A 1992 Filene Institute study on field of membership stated:

Perhaps the most serious unresolved field of membership issue is competition among credit unions. Traditionally, a strong anti-competitive nature was instilled in credit unions by their cooperative philosophy and by regulatory policies. Federal chartering policy is still officially stated in a strong anti-competitive manner. However, times have changed. Today's financial service environment is one of intense competition. In such an environment only the most efficient survive, and competition forces efficiency. Restraints on field of membership expansion, solely because they result in competition with other credit unions, could lead to the death of both the credit union wishing to expand and the credit union wishing to have its field of membership protected. They could both die at the hands of a competitor - probably a commercial bank.

Albert E. Burger and Tina Dacin, *Field of Membership: An Evolving Concept*, page 49, Madison: Filene Research Institute (1992).

Another Filene study looked at the effect of the change in Utah's FOM policy in the early 1980s. The change allowed Utah state credit unions to offer services to as broad a group of citizens as they chose. The study, conducted in 1994, concluded that the policy change did not lead to a few large credit unions driving smaller credit unions out of the market. At the time of the study, one-third of Utah credit unions had assets of \$1 million or less. Ramon E. Johnson, *Field of Membership and Performance: Evidence from the State of Utah*, Madison: Filene Research Institute (1994).

Unlike the policies of the National Credit Union Administration, the Washington State Credit Union Act is not anti-competitive in its tenor. It does not require the Division to deny FOM expansions based on anti-competitive or protectionist notions. To the contrary, the Act charges the Division with the duty to "ensure that state-chartered credit unions remain viable and competitive in this state." RCW 31.12.015. Consistent with the Filene study quoted above, we believe that a policy of protecting credit unions from competition will not ensure their viability or their competitiveness. Our policies allow more than one credit union to include the same community in its FOM.

In October 1994, the Credit Union National Association (CUNA) issued a news release which provided:

Although overlap can be an emotional issue, CUNA's Field of Membership Task Force believes there is only one way to examine it objectively. Rather than taking the perspective of credit unions or trade associations, the Task Force is taking the perspective of consumers.

From the consumers' perspective, overlap is a non-issue. Access to more than one credit union simply provides a wider array of credit union services, and decreases many consumers' need to use for profit institutions for certain financial services.

If we tried to protect consumers from overlaps, all we'd be doing is preventing them from receiving the services they want - and driving them to banks and other competitors instead of keeping them in the credit union movement.

As CUNA pointed out, by denying FOM expansion, based on protectionism, we would be effectively denying consumers another valuable choice in the marketplace.

Based on these considerations, we have concluded that approval of B's application does not present an immediate threat to the viability of A under WAC 208-472-075(7).

For your information, our policies do provide some limited FOM protection, but only from direct overlaps in the same occupational or associational group, with certain exceptions. This long-standing policy originally grew out of a concern for the financial impact that such direct overlaps could have on small credit unions that were reliant on only one or two occupational or associational groups. This policy is still reflected in our current rules. See WAC 208-472-025, 050.

2. Comment: The approval of B's application by the Division constitutes the granting of an "unfair" competitive advantage to B.

Response: As you are aware, the dual chartering system offers credit unions a choice between a state and federal charter. The nature of the dual chartering system is that a competitive tension exists between the policies of the two systems. There are many similarities and many differences between the policies of each. There are also distinct advantages and disadvantages to each, depending on the business strategy of the credit union. It is generally agreed, however, that state charters are often better able to innovate to serve the needs of their members. Over the years, as the relative appeal of each charter has risen or fallen, we have experienced conversions in both directions. The beneficiaries of this scenario are the credit unions and their members.

In this instance, B is entitled to exercise its powers to the fullest extent permitted by state law, without regard to whether it may disadvantage other state or federal credit unions. To the extent you have concerns that policies established by Congress or NCUA may place federal credit

unions at a competitive disadvantage, these concerns should be addressed to the policymakers in Congress or the NCUA.

3. Comment: An approval by the Division of B's application, which will create a complete overlap of A's smaller, federally chartered "community" field of membership, would be unprecedented.

Response: We disagree. We believe that in several other situations such complete overlaps have been approved by the Division or the NCUA.

4. Comment: If federal or state credit union regulators begin to approve complete field of membership overlaps, that pit credit unions directly against each other, the very foundation of the credit union movement, that of mutual cooperation between credit unions, will be placed in severe jeopardy.

Response: Certainly, competitors probably won't be too interested in cooperation. However, there is no reason credit unions generally cannot find ways for meaningful cooperation. The 1992 Filene study quoted above states (at page 49):

It is important that credit unions continue to acknowledge the importance of their founding ideals and embed them in the structure of the current credit unions. While competition will force individual credit unions to operate at a high rate of internal efficiency, it does not necessarily negate the benefits of cooperation. There is no reason for credit unions and their members to throw away the basic cooperative values of equality, equity, and mutual self-help. For example, through mutually beneficial cooperation, credit unions can achieve efficiencies with regards to the sharing of information, the diffusion of new innovations, and the sharing of services.

5. Comment: A wishes also to challenge B's application on the basis of WAC 208-472-015(4), the proper definition of a community. We are not challenging the definition as it applies to C as described in B's application, but rather the implication that there is some sense of a continuous community between C and "D".

Response: Under our rules, B may have one or more communities in its FOM, whether or not contiguous. There is no requirement that the communities of C and D be one and the same community.

6. Comment: A believes that a "community" FOM overlap cannot benefit the citizens of the communities of either C or D.

Response: We disagree. As discussed in our response to comment #1 above, competition between credit unions (and other financial institutions) enhances consumer choice in the marketplace, and makes credit unions more efficient, thereby providing additional consumer benefits.

AUGUST 30, 1996 LETTER

7. Comment: WAC 208-472 indicates that an application for a field of membership expansion that "reasonably threatens the viability of another credit union" or one which overlaps another credit union's field of membership as defined by employment or association may not be approved by the Division.

Response: We disagree. The criterion listed in WAC 208-472-075(7) is: "Whether approval of the application might reasonably threaten the viability of another credit union." In most cases we would deny an application that presented such a threat. However, Subsection -075 lists criteria for our consideration, and does not require us to deny an application if one or more of the criteria are present.

As noted above, there are certain restrictions on the approval of applications that present direct overlaps in the same occupational or associational group. However, even in these cases, an application presenting a direct occupational or associational overlap may be approved if it falls within one of three specified exceptions, e.g., if a certain percentage of the group desires service from the applicant credit union. WAC 208-472-025(3), -050(3).

8. Comment: What are the circumstances that make up a "reasonable threat to the viability of an existing credit union", if not the circumstances in this case?

Response: Please see the response to comment #1 above,

9. Comment: We contend that the approval by the Division of complete overlaps of the FOM of a smaller credit union by a significantly larger credit union will in itself present a threat to the continued viability of the smaller credit union.

The viability threat in this case is just much, much greater when the smaller credit union happens to be federal and operating under the laws governing federal community charter credit unions.

Response: Please see the response to comment #1 above,

10. Comment: Nothing in WAC 208-472 indicates that a conscious decision has been made to grant complete overlaps of the FOM of an existing credit union.

Quite the contrary, WAC 208-472 seems to have been written presuming that there would be viability consequences to complete FOM overlaps and therefore it precludes their approval in many of its provisions.

Response: As noted above, our rules only restrict direct overlaps in the same occupational or associational group, with certain exceptions. Approval of other types of direct or indirect overlaps is not restricted under our rules.

11. Comment: It is our position that the Division's rules requires that a FOM expansion application comply with WAC 208-472-065(8). B's application does not comply with this rule and therefore should not be approved. The application in order to comply with this rule must include a provision that B will not direct market to any occupational or associational group within C because they are all within the FOM of A.

Response: Credit unions with a community group in their FOM may take as a member any person that lives, works, or worships in the community. After the inclusion of a community in its FOM, a credit union may not direct market to occupational or associational groups (in the community) that are expressly part of the FOM bylaw of another credit union. WAC 208-472-065(8). This rule is an extension of the limited overlap protection afforded to occupational and associational based credit unions.

However, this rule does not apply in the current circumstance because A gave up all of its SEGs when it became a community charter credit union. If we widen the scope of the direct marketing restriction to apply in this case, I believe we would soon be faced with a multitude of different factual situations which would require us to sort out, based on some general notion of equity, in what circumstances the rule should and should not apply. We have chosen not to open up this Pandora's box.

12. Comment: Our contention here is in reference to the WAC 208-472 provision against a credit union applying for a field of membership simply to circumvent another credit union's marketing plans.

Response: I believe that you are referring to the criterion listed in WAC 208-472-075(8): "Whether the applicant is using the inclusion of the group as a marketing strategy to preempt expansion by other credit unions." Our concern here is that a credit union may add a new group in order to preempt another credit union from adding the group to its FOM, without any real intention of serving the group. This concern arises primarily with occupational or associational groups, where some measure of overlap protection is provided. B's application is for a community, not an occupational or associational group. Moreover, Subsection (8) is inapplicable because C is already in the FOM of A.

13. Comment: Another provision of WAC 208-472 is that the applicant credit union provide information whether the applied for FOM is large enough to have its own credit union.

Response: I believe that you are referring to the criterion listed in WAC 208-472-075(4): “... whether the proposed new group has sufficient size and resources to form a credit union of its own.” However, subsection (4) by its terms applies only to the inclusion of occupational or associational groups, and is therefore not applicable to the B’s application.

14. Comment: The fact that the Division required service and penetration plans to be submitted with B’s application and now is requiring documentation of the actual results attained, indicates that the Division expects a credit union to accomplish what it sets out to do in one area before promising to accomplish even more in another area.

Response: WAC 208-472-075(6) lists another criterion: “Whether the applicant has complied with plans on penetration and service submitted with previously approved applications for inclusion of a group in the applicant’s field of membership.” Our concern here is that a credit union may add new groups to its FOM without intending to make real efforts to serve the groups. What we are looking for is an indication whether the applicant credit union is making bona fide efforts to serve the groups in its existing FOM.

However, we do not intend to dictate minimum penetration or service levels of existing groups which must be reached before a credit union is eligible for Division approval of the addition of new FOM groups.

Please contact me if you have any further questions about our decision on B’s application or our policies on FOM expansion.

Sincerely,

J. Parker Cann
Assistant Director