

Eva Holbrook

English 1010

MW James Hirst

Argument Essay

Credit Unions vs. Banks

Like many youths right out of high school, I was looking forward to a bright ambiguous future. I could continue onto college and complete my academic path or I could find a job and learn some necessary “adult” skills of independence and budgeting. But whether I chose one path or the other, one thing was certain; I desperately needed to learn how to handle my own finances. Not knowing where to start I fell back on my Mother’s wisdom and opened my first Bank Account. Unbeknownst to me, my mother was swimming up to her eyeballs in debt and was in the process of declaring bankruptcy. She recommended I go to a local bank that was offering a free \$100 deposit into your account for new customers if you met certain criteria. I thought, “heck why not! It’s a free \$100.” So I joined the bank, but it did not benefit me in the long run. The Loan Officer that I worked with cross-sold me everything an 18 year old with no credit history could qualify for: a savings, a checking, and my first credit card. I ended up not saving any money, going negative in my checking account, and maxing out my credit card after a few months. I soon had collection agencies calling me everyday because I didn’t have a job to make the payments on all of my sudden debt. It wasn’t until much later that I realized why I failed. The Loan Officer was so gung-ho in selling me everything he could that he failed to ask me a few simple questions that would have saved years of repair.

At the naïve age of 18, I was wholly unaware that there were more, and potentially better, options in the fiscal world available to me. Banks are not the only options; there are also local banks and credit unions. They all compete intently for customers (like offering a free \$100), but in the end, which type of financial institution is better? While both banks and credit unions offer a similar range of services, credit unions are better because they are stable, nonprofit organizations that care about people.

In 2008 the U.S. was hit with one of the largest financial crises seen in years. Several large financial institutions (including Washington Mutual with \$307 billion in assets) went bankrupt and either had to be bailed out by the government, absorbed into other institutions, or allowed to go under. A lot of Americans got nervous and started to shy away from the big banks and move their assets over to small banks and credit unions.

Of course, given that the Federal Deposit Insurance Corp. has decided to insure deposits up to \$250,000 from \$100,000 previously, it's not as if many people will lose their deposits. Rather, the fears on Main Street reflect how shaken the public has become from the financial turmoil. And the government's efforts to save the financial system from collapse by investing in some of the country's largest banks have only spooked Americans further. (Gogoi)

American's newfound faith in small banks and credit unions is not misplaced however. Credit unions have been able to fill the void that consumers have felt by lending when banks will not. "Overall, credit union loans grew by almost 3% in the year ending September 2009, whereas bank loan portfolios declined by over 7%" (Schenk). Credit unions have also suffered less than

half the rate of charge-offs on those loans than their large bank counterparts. The reason for this is because their business practices are sounder than the banking practices.

The [main] contributors to poor bank performance seem to be (in no particular order) fraud, mismanagement, nepotism, overly aggressive expansion, too many big branches, bad pricing decisions (on either side of the balance sheet), too much credit risk (i.e., overly-aggressive lending decisions), weak ALM, misguided investment decisions, bad service, and lack of synergy in mergers. This, as most bank consultants will tell you, is not an exhaustive list (Schenk).

Small bank and credit union business practices are centered on securing their loans with “real assets such as property, equipment, receivables and even personal guarantees from senior management, which makes for better loan recovery in case of failure” (Gogoi). Which means you can trust your credit union to not go under when bad times like the financial crisis hit. It also means that that banks have forgotten that when their customers are financially stable, their institution is financially stable.

If you are already part of a credit union then you may have noticed that the moment you enter the building the employees are friendly and seem to always know your name. If they don't know your name, they go above and beyond to welcome you and help you with your financial needs. They don't pressure you into something you don't want, but instead seek opportunities to help you succeed financially. Part of how they do that is by keeping their interest rates on loans low and their dividends earned on deposits high. The reasons they can keep their rates so great is because each credit union is set up as a nonprofit organization. Credit unions first came into existence because low income families such as farmers, coal miners, etc. were refused business

at banks. So they decided to come together and make their own institution that would serve their needs. The money they pool together can then be loaned back out to each other. “In essence, members pool their money and make loans to one another” (Augstums). The money earned from the interest on the loans is then put back into the institution to be used for the members. Because the credit unions are set up like this, they are considered nonprofit and are not taxed by the state or federal government for income. “For this reason, credit unions are generally able to offer better interest rates on loans and deposits than banks” (Augstums).

Investors seeking opportunities to make money, on the other hand, set up banks. Whatever money they lend out, the interest earned on those loans is paid back to the investors instead of the customer. The downfall of this is that it is counted as income because it gets paid back to the investors and therefore it is taxed as income. Banks are much bigger so they also have more assets. With more money to spend they are able to facilitate huge loans to big business. The average American doesn't need a large loan, so banks are better suited for the wealthy consumer. “Some people may prefer a package of services offered by a big bank. Those who have a lot of business transactions or are of great means may be better off at a bank” (Augstums). Banks also are not restricted to who they can conduct business with and can have branch locations nationwide, which is convenient for consumers. “But more branches do not necessarily mean better customer service. Many customers complain about the service they get at large banks, which can give the impression you are known not by your name, but by your account number”(Augstums). Credit unions are known for their more personalized services. Because their primary philosophy is “people helping people,”(What) that is what they strive for instead of trying to make a profit.

Credit unions also help consumers who decide to join with banks too. “Credit union presence in the marketplace makes bank pricing more consumer-friendly than it otherwise would be. The benefit this moderation influence has on bank customer pricing is estimated by CUNA to total \$5 billion in the year ending September 2009”(Schenk). So even if you decide to go with a bank, you still reap the benefits of credit unions because they keep each other in check.

The banking industry is upset because credit unions are tax exempt and therefore can offer better rates to consumers. Banks complain that credit unions are trying to be like big banks with all the services they provide, but aren’t held to the same rules and restrictions that banks are. They also complain that because they are not liable to the same rules and regulations that banks are, they are growing too big and banks are unable to compete. But in reality, “Each of the nation’s four largest banking entities are larger than the entire credit union movement. The average banking institution is fourteen times larger than the average credit union (\$1.6 billion vs. \$115 million in assets)”(Schenk). Banks also claim that credit unions are growing too fast for banks to keep up, but “it took 100 years for credit unions to grow to a total of \$885 billion in assets. In contrast, U.S. banking institution assets grew by a similar amount (\$986 billion) in the past 39 months” (Schenk).

Despite the facts, banks took their complaints to court and sued the credit unions in 1990 for “ignoring their 63-year-old federal charter and admitting almost anybody as members”(Falstad). Credit unions felt that it was unjustified and that banks really just wanted force them out of business by cutting off their membership growth. The banks did win, but the lawsuit didn’t stop credit unions from being tax-exempt, it just forced them to limit their membership to their original common bond, or in other words, what their charter originally stated their membership field to be. It was a win for the banks though because credit unions

started “losing 4,400 new customers a day or 1.4 million people a year”(Falstad). In time it may prove to have little effect because consumers are smart and will seek out the best deals to serve their needs.

A fair question to ask is; why do banks complain so much about the unfair regulations placed upon them?

If bankers really believed that credit unions had unfair competitive advantages they would convert their institutions to credit union charters. None do this however because doing so would expose them to democratic ownership and control, would likely cause banker salaries to decline dramatically, and would force these institutions to adhere to a more restrictive regulatory regime, including higher capital standards (Schenk).

So in reality, banks still care too much about their bottom line and what they can make off of customers. They make poor business choices that make them a lot of money in the short term, but in the long run causes events like the financial crisis of 2008. We should all join the credit union movement to support sound business practices, and the philosophy of “people helping people”(What). When customers succeed, businesses, the economy, and the government succeed too.