Subject: Wyoming State Issue Working Group Priority: Comparative Analysis of the State and Federal Charter

General Comments

This white paper is provided as a follow-up to the Wyoming State Issues Working Group process which identified as a priority a comprehensive review of the pros and cons of pursuing a state charter.

In the GoWest region, having a state charter has provided credit unions with options perhaps not available in the federal charter model. Having a state or federal charter choice allows credit unions the freedom to determine which option best serves their members.

Below is a breakdown of assets in the five GoWest states with both federal and state charters.

State charters - 139 state charters, 88% of assets.
Federal charters -127 federal charters, 12% of assets.

Should Wyoming credit unions choose to pursue the creation of a state charter, they would work together to define the parameters that reflect the values of the state. For example, Wyoming might consider protecting credit unions from denying services and capital to small businesses engaged in the energy, agriculture, timber, and firearms industries while Federal lawmakers might enact legislation requiring financial institutions to adopt ESG standards.

Federal Charter Advantages

Consistent regulations – Being under federal oversight means that federally chartered credit unions have the National Credit Union Administration (NCUA) as a single regulator and insurer. This is particularly valuable for multi-state federal credit unions.

For state charters with operations in multiple states, it can be challenging and costly to navigate differences in state laws. We have seen that credit unions with operations in more than five states tend to prefer the federal charter. The National Association of State Credit Union Regulators (NASCUS) recognizes this threat to the state system and is working on a modern interstate agreement that will help facilitate interstate operations for state charters.

Tax Advantages – Federal credit unions (FCUs) have the benefit of being chartered as instrumentalities of the United States under internal revenue code 501 c1. State-chartered credit unions are chartered under 501 c14 of the internal revenue code. The 501 c1 designation provides greater tax benefits than the 501 c14. FCUs are not required to file 990s or any tax returns, and they do not have to pay sales, lodging, or some other taxes. As an example of how those savings can add up, a federal credit union that purchases all the building materials for a new building could save as much as 10% in some states. Additionally, one large credit union estimated that it saved nearly $200k in lodging costs by requiring staff to use their federal tax exemption when traveling. However, at least one state – Montana -- confers all the tax benefits of Fed charters to state charters.

State Charter Advantages

General benefits – State-chartered credit unions in the GoWest Region have greater flexibility in terms of operations, lending, investments, membership, optionality, powers, and other unique provisions. Additionally, state-chartered credit unions in the GoWest Region generally report that state supervisory authorities provide tailored supervision, faster response times, and often remind the NCUA who the primary regulator is during exams. GoWest has demonstrated a strong track record of working with state legislatures to modernize statutes and regulations, typically every two years. The Federal Credit Union Act, on the other hand, was last comprehensively updated in 1998 with the passage of the Credit Union Membership Access Act.

Parity – One of the biggest advantages of the state charter is the ability to utilize parity to ensure that state charters can do anything that federal charters can do. The best example of a state parity provision is automatic federal parity and the ability to ask the prudential regulator for provisions from other state credit union acts or bank acts. This allows state credit unions to compete on an even playing field with other financial services providers.

Field of Membership – Many state credit union acts include broad FOM provisions such as the ability to mix and match types of charters and expand relatively easily into other states. Some states even have explicit nationwide FOM with no restrictions.

For example, PenFed got its nationwide FOM by merging in a troubled New York state-chartered credit union that had a legacy nationwide FOM. Because the merged credit union was in troubled condition, PenFed was able to absorb the state charter's FOM. State acts tend to be more flexible in allowing merging credit unions to combine FOMs in mergers regardless of troubled condition. Some state acts allow Federal charters converting to state charters to retain their Fed FOM and add permissible state FOMs during the merger/conversion process.

Private Insurance – Some states offer the ability for a credit union to choose private share insurance eliminating the need to follow NCUA 741 regulations and removing the NCUA completely from oversight. Until recently, one state allowed credit unions to self-insure which meant that the exam was solely a consumer compliance exam rather than a safety and soundness exam.

Assessments – In GoWest states, assessments are on average 30 percent less than the operating fees that FCUs pay and as assets have grown, GoWest has worked to reduce assessments.

Incidental Powers – Many states have crafted incidental powers provisions that provide broad autonomy to execute non-enumerated powers. Federal credit unions are restricted to a prescriptive list of incidental powers.

Governance and Operations – State charters have significant governance advantages over federal charters. Examples include:

- **Bylaws** – Some state charters allow for credit unions to create and maintain their own unique bylaws and state that bylaw amendments do not have to be approved by regulators. FCUs have a mandated set of very prescriptive bylaws. Because FCU bylaws are in some instances beholden to out-of-date statutes, the NCUA has not been able to fully modernize their bylaws. For example, the statute prohibits compensation of directors. However, NCUA board members and a number of senior NCUA staff have supported director compensation.

  Examples of Flexible Bylaws Provisions
  - Amendments allowed without regulatory approval
  - Broader membership
  - Joint membership
  - Clear expulsion provisions
  - Virtual annual meetings and greater meeting flexibility
  - Higher bar for calling special membership meetings and greater flexibility to hold virtually
  - Greater flexibility on what constitutes a quorum
  - Ability to eliminate requirement to have a supervisory or audit committee
  - Greater flexibility to remove directors

- Ability to compensate directors
- Greater flexibility on defining duties of the board and delegable duties
- Proxy voting allowed
- Election flexibility
- Board combinations in mergers

- **Membership Share** – Some state charters do not require membership shares. This allows credit unions to use other types of accounts to qualify a member. For example, an individual can get a loan and that loan account works as the membership account. Credit unions that have deployed this have reported that it has resulted in increased demand for products and services as it simplifies the customer experience.

- **Definitions** – Effective state acts have modernized definitions sections. For example, state acts may allow for domestic partnerships and committed intimate relationships to count as family for purposes of membership. A state act may have a broader definition for qualifying for low-income designations.

Lending

- **General**

  - **Interest rate cap** - Most states do not set an artificial interest rate cap. The Fed is currently set at 18%.
  - **Unsecured lending** – Many states allow unsecured lending with no restrictions on maturity or the amount of an unsecured loan. At the Federal level there are 15-year maturity restrictions on unsecured loans.
  - **Subordinated lending –** Many states do not restrict the terms of subordinated loans where the Fed restricts subordinated lending to 20 years.
  - **Unimproved property loans –** Many states do not restrict the terms on unimproved property loans.
  - **Loans to CU officials –** Many state acts permit higher limitations on loans to CU officials or do not restrict loans to CU officials. At the Federal level it is $20K unless approved by the board.
  - **Concentration limits –** Many states have very few restrictions on concentration limits.
  - **Participations –** Many state acts have greater permissibility around the amount of participations that can be purchased.

- **Commercial**
    - **Flexible state MBL rules** - A handful of states have adopted their own MBL rules that are interpreted by the states, often with fewer restrictions than at the Federal level. For example, Washington has language that allows the state regulator to grant an exception to the cap.
    - **Pre-payment penalties allowed** - Many states allow credit unions to charge prepayment penalties on commercial loans which is not allowed at the Federal level. State credit unions report that this is critical to their ability to compete for Member Business Loans.

Investments

- **Permissibility** – the strongest state acts specifically authorize broad investment authorities including the ability to invest in any permissible investment that is allowable for any other financial institution operating in the state.
- **Equity investments –** Some state acts allow for equity investments in non-CUSOs, including VC funds, privately held businesses, and publicly traded companies. The most expansive state act allows a credit union to purchase a bank through equity.
- **CUSO limitations** - Federal credit unions have a limited ability to make CUSO investments. Many states authorize much higher CUSO investment limits, for example Washington allows up to 10% of net worth.

Exams and Regulatory Oversight

- **Approvals** – The best state acts have very few requirements for regulatory approvals. Instead, they allow credit unions to use notifications or are deemed approved unless the regulatory agency determines there is a safety and soundness concern.
  Examples include:
    - Branching which can be a simple notification
    - Interstate Branching which in some state acts is as simple as following the procedures outlined in host state
    - Bylaw updates which in some acts can be done autonomously.

- **Credit Union Oversight** – Many state regulatory agencies have boards and commissions that exercise some oversight over regulatory agencies.