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Another low-income CU draws record secondary capital investment

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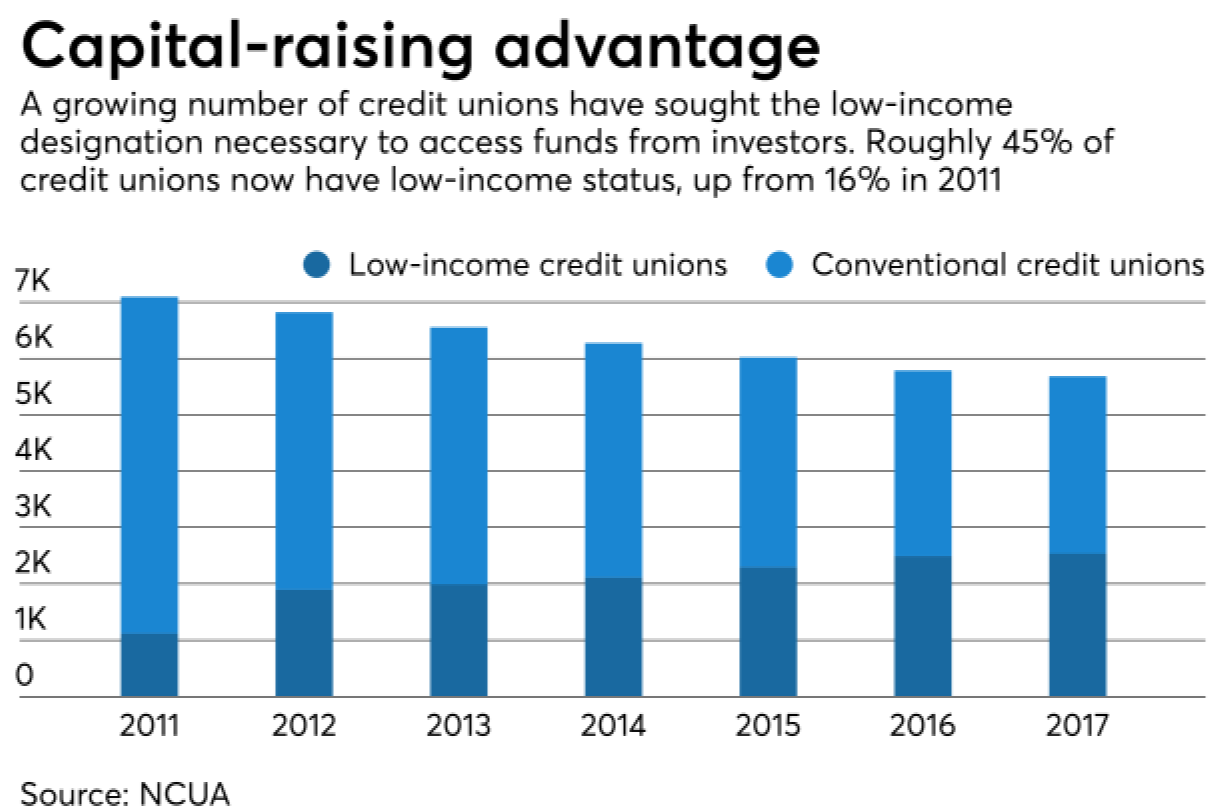
A second credit union has announced plans to take on a record amount of secondary capital, a trend that is alarming bankers and drawing attention from other credit unions.

Notre Dame Federal Credit Union in Notre Dame, Ind. said late last week that it raised $12 million from a new fund created to provide secondary capital to credit unions. That followed a move by Jefferson Financial Federal Credit Union last month, which disclosed plans to bring on an identical amount as part of a transaction credit union officials called the largest secondary capital raise in the industry's history.

The $530.2 million-asset Notre Dame, which has been growing loans significantly faster than banks and other credit unions, plans to use the new capital to drive further growth.



"This injection of secondary capital…provides us the potential for immediate growth that otherwise would have taken years to achieve," Notre Dame CEO Thomas Gryp said in a press release.

Through the first nine months of 2017, Notre Dame grew its loan portfolio 12.35% to $450.2 million. Over the same span, loans industry-wide grew less than 8%; banks, by contrast, saw their loans grow just 2.7%.

Gryp labeled secondary capital a potential “game-changer.” Dennis Dollar, a former chairman of the National Credit Union Administration who now works as a prominent industry consultant, said that “there is no question there is a growing demand for capital” among credit unions seeking to expand their branch networks, upgrade technology or venture into new lines of business.

“I don’t think supplemental capital will ever be a way for a poorly capitalized credit union to build its net worth because the cost is just too high...but it could become a viable option for a well-capitalized credit union that needs dollars for strategic investment,” Dollar wrote Tuesday in an email to American Banker.

Overall, the amount of secondary capital on credit unions’ books remains relatively small, totaling $150.6 million at the end of the third quarter, so it hasn’t been a hot-button topic for banks — but that may be changing.

“It’s a trend we’ve been watching,” Brittany Kleinpaste, director of economic policy and research at American Bankers Association said in an interview.

In a similar vein, James Kendrick, first vice president for accounting and capital policy at the Independent Community Bankers of America, called secondary capital use by credit unions “a troubling issue.”

“It shows a theme that’s emerging with credit unions in general. They’re misusing the purpose of the credit union charter and growing into these large, too-big-tofail financial institutions," Kendrick said. "Hopefully members of Congress will take notice."

By law, only institutions that have been designated as low-income credit unions by the industry's regulator, the National Credit Union Administration, can issue secondary capital. But the number of credit unions with the low-income designation has been increasing steadily, even as the total number of credit unions has declined. Through Sept. 30, a total of 2,538 credit unions were designated as low-income, up from 1,119 in 2011.

"Now, we're seeing these credit unions becoming comfortable and figuring out how they can use that designation to their advantage," Kleinpaste said.

Michael Macchiarola, a partner at Olden Lane Advisors LLC, which created the new Credit Union Secondary Capital Fund in partnership with Credit Union Capital Management Services, an Overland Park, Kan.-based credit union service organization, said it was created solely to provide secondary capital to credit unions.

"We are pleased to be able to assist in their responsible growth and offer lenders an attractive return on a diversified pool of borrowers at the same time," Macchiarola said in a press release last week.

Neither Olden Lane nor Credit Union Capital Market Solutions responded to a request for comment.

Last month, working without Olden Lane, Credit Union Capital Market Solutions arranged a deal that yielded $12 million in secondary capital for Metairie, La.-based Jefferson Financial.

Both Notre Dame and Jefferson Financial acquired their capital in the absence of a comprehensive regulation governing the use of alternative capital by mainstream credit unions. NCUA has been in the process of drafting such a plan for nearly a year, and Dollar urged them to finish the job.

“To their credit, NCUA is actually approving some of those [applications],” he wrote. “They now need to enact a regulation putting some meat on the bones so that eligible credit unions can know how to structure their supplemental capital initiatives and to make sure they are within a safe harbor of what NCUA will allow.”

Kleinpaste and Kendrick had a different suggestion. Credit unions weighing the use of secondary capital should explore becoming banks, instead.

The ability to tap capital markets, expand member business lending authority and widen fields of membership “all serve to make credit unions look more like banks,” Kleinpaste said.