

CREDIT UNION LEGISLATION

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This is to certify that the

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*Credit Union Legislation*

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CREDIT UNION LEGISLATION

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## ABSTRACT

Within the last ten years, credit unions in the United States have assumed major importance as suppliers of consumer credit, and as institutions where the working man may invest his savings. As credit unions have grown in importance, there have arisen grandiose claims for and against credit unions, in regard to their mode of operation, and the legislation of them. This study was written in an attempt to examine credit unions in order to substantiate or refute these claims, with special emphasis being placed on Michigan credit unions and the Michigan Credit Union Act.

Discussion begins with a section on the historical background of credit unions, which includes the nature of a credit union, tracing the development of credit unions in the United States since 1900, and in Michigan since 1925, and a brief summary of the major provisions of the Michigan Credit Union Act.

The protection of members' funds, provided by the existing credit union legislation, is next examined by discussion of the credit union legal requirements relating to membership and capital, loans, reserves, supervision, and regulation by state or federal authority.

Credit union liquidations, both Michigan-chartered and federal-chartered, are examined to determine the causes of liquidation in order to discover whether or not these liquidations could have been prevented by improved credit union legislation.

Regulation of financial institutions, performing functions similar to credit unions, is examined to determine the validity of claims that credit unions are operating under legislation which favors credit unions, while discriminating against other similar institutions.

From the information presented and the recommendations made, the author has endeavored to compile a list of suggested revisions applicable to any credit union bill, which, if adopted, would improve both the safety provided for members' funds and increase the operational efficiency of credit unions, while not attempting to stifle their growth potential. The final pages of the study are devoted to suggested areas of further study, which the author believes desirable, for future judgment of credit unions.

## ACKNOWLEDGMENTS

The author wishes to express his sincere thanks to Dr. Richard W. Lindholm, under whose inspiration, supervision, and interest this investigation was undertaken and to whom the results are herewith dedicated.

Grateful acknowledgment is also due to Mr. Delmar C. Nagel, Deputy Commissioner, State Banking Department; Mr. Ralph L. Stickle, Executive Manager, Michigan Bankers Association; Mr. C. J. McLanahan, Director of Training, Michigan Credit Union League; and Mr. David Arsenault, Treasurer-Manager, Wyandotte Chemicals Employees' Credit Union, all of whom have donated freely of their assistance and advice.

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## INTRODUCTION

As the industrial revolution captivated the American economy, forcing people off the farm into the industrial centers, wage earners became dependent on a money income. Whenever the family income stopped or was strongly subjected to extraordinary demands, credit had to be found to fill the gap between consumption and income.

Loan sharks were the first to fill the gap, answering the need for small loans. Operating outside the law, the loan sharks charged prohibitive rates of interest. It was not very long before these abuses began to be seen and felt by the public, and agitation for small loan agencies, which would charge low rates of interest, became the topic of the day.

One approach to the problem of supplying credit for the masses was the development of cooperative credit unions. With the passage of special credit union enabling acts by the individual states and by the federal government, credit unions rapidly became accepted by the American people, to the point where on March 15, 1954, one out of every nine workers in the United States was a credit union member in one of the 14,585 credit unions in operation on that day, who had

a combined asset value of over two billion dollars and loans outstanding of \$1.5 billion and deposits of over \$1.8 billion.

Credit unions did not really reach an important financial status until the years following World War II. Previous to that time little attention was paid to the credit unions. But since their rapid growth more and more persons connected with consumer credit have begun to look at the operations of credit unions and their legal structures. The above examinations have given rise to grandiose claims and disparaging countercharges, making credit unions a lively topic of discussion.

The purpose of this study is to evaluate the legislation governing credit unions, with emphasis on the Michigan Credit Union Act, and to suggest possible legislative and administrative improvements in their operations.



## CHAPTER I

### HISTORICAL BACKGROUND

#### Nature of a Credit Union

A credit union is a union of persons, having a common bond of interest, in a financial association whose principal purpose is the extension of short-term credit to its members at low rates of interest, and the promotion of thrift among its members<sup>1</sup> by the systematic sale of shares and acceptance of savings deposits.

The members of a credit union have a common bond of interest, other than the credit union, through having a common employer, common membership in a fraternal society, religious organization, or having residence in a well-defined community.

In the United States commercial institutions make consumer credit available to different strata of borrowers. The credit union is one of these specialized consumer credit agencies. Its distinguishing appeal lies in the broader basis of self help through co-operation rather than in the profit motive of other agencies.

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<sup>1</sup> Roy F. Bergengren, Credit Union North America, Southern Publishers, Inc., Kingsport, Tennessee, 1940, p. 5.

A credit union receives all of its capital in cash from members who buy shares and/or make deposits. Each member in effect becomes a stockholder. His investment in the credit union is evidenced by shares which can be bought outright or on installments. These shares differ from ordinary or common stock of commercial corporations because they can be turned into the credit union for cash at the will of the holders.

Many credit unions secure additional working funds by accepting deposits of members and of their families. Deposits are more informal investments than shares. They receive a lower fixed return than the share dividend, and have a prior call on assets, in the case of failure, than do shares.

Credit unions may borrow additional capital from banks or other credit unions, but borrowings are intended merely to supplement the paid-in capital.

The funds which are accumulated by a credit union may be loaned only to its members, or to another credit union, for provident or productive purposes, at interest rates, in Michigan, not to exceed 1 percent per month on the unpaid balances of a loan.<sup>1</sup> The

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<sup>1</sup> Act 285, P. A. 1925, State of Michigan, State Banking Department, Lansing, p. 1.

amount loaned to any individual or any credit union, and the terms of the loan are subject to restrictions imposed by law.

Credit unions have a corporate form of organization and must receive legal authorization to operate from either the federal government, the District of Columbia, or one of the forty-four states which have enacted enabling legislation. In Michigan, credit unions may be organized under the provisions of the state banking law relating to credit unions and are subject to supervision by the State Banking Department.<sup>1</sup> Residents of Michigan may also organize credit unions under the terms of the Federal Credit Union Act, which is administered by the Bureau of Federal Credit Unions in the Federal Security Agency.<sup>2</sup>

#### Credit Union Development

Although the history of co-operative credit dates back over a century, modern credit union history began in 1900 with the organization of the 'People's Bank' at Lewis, Quebec, by Alphonse

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<sup>1</sup> Ibid.

<sup>2</sup> Federal Credit Union Act, June 26, 1934, Federal Security Agency, Washington, D. C., pp. 1-2.

Desjardins, a journalist.<sup>1</sup> Aroused by the effects on the poor people in Montreal of the activities of unscrupulous and usurious money lenders, he organized credit societies among rural parish groups. Shares were of small denominations: liability was limited; dividends were paid to shareholders; deposits were accepted, but only from members; and "redemptive" as well as "productive" loans were granted.

Early in 1909, Desjardins came to Boston and aided in drafting the bill which made Massachusetts the first state to authorize credit unions. Edward A. Filene, a wealthy Boston merchant, played an important role in the development of Massachusetts credit unions.<sup>2</sup> While this legislation was being adopted, Desjardins went to Manchester, New Hampshire, where he helped set up one of his "People's Banks" named La Caisse Populaire Ste. Marie, which enjoys the distinction of being the very first credit union to be organized in the United States.<sup>3</sup> Massachusetts became the first state to enact

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<sup>1</sup> Maxwell S. Stuart, Credit Unions--The People's Banks, Public Affairs Pamphlet, No. 50, Public Affairs Committee Inc., 1942, p. 3.

<sup>2</sup> Ibid.

<sup>3</sup> Stuart, op. cit., p. 3.

a credit union law, enacting it in 1909 and it became a model for effective credit unions to follow for twelve years.<sup>1</sup> Other states followed Massachusetts rather haphazardly until 1921. In that year Edward A. Filene and Roy F. Bergengren established the Credit Union National Extension Bureau for the purpose of amending those laws passed by states prior to 1921 which were hopelessly defective, and for the promotion of a uniform credit law as a basis for any future enabling legislation. After 1921 state after state passed enabling legislation and in 1934 Roy F. Bergengren wrote a federal bill which was introduced by Senator Morris Sheppard of Texas, signed by President Roosevelt, and enacted, enabling credit unions to be chartered anywhere in the United States and its possessions, by the federal government.<sup>2</sup>

#### Michigan Credit Union Legislation

The Michigan credit union law dates from 1925 when Roy Bergengren was introduced to Bert Cody, Chairman of the Republican State Committee, of the Michigan Republican Party, which was the

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<sup>1</sup> Ibid., p. 4.

<sup>2</sup> Roy F. Bergengren, Crusade, Exposition Press, New York, 1952, p. 82.



majority party at that time. Mr. Cody was able to have George C. Watson, of St. Clair County, introduce House Bill 110, to provide for the organization, operation, and supervision of credit unions in Michigan.<sup>1</sup>

The bill passed the House and was sent to the Senate where it was amended and returned to the House. The House approved the amendment and presented it to Governor Alexander J. Grosbeck, who approved it on May 13, 1925, and it became Public Act 285, to be effective August 27, 1925.<sup>2</sup>

The credit union act of 1925 was amended in 1929<sup>3</sup> and 1941.<sup>4</sup> However, they were very minor changes and the existing law is the same as that adopted in 1925.

Previous to the passage of the Michigan Credit Union Act, there were a few credit unions in existence in Michigan. However, it can reasonably be surmised that the extent of their operations

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<sup>1</sup> Bergengren, Crusade, op. cit., p. 86.

<sup>2</sup> Michigan House Journal, Robert Smith Co., Lansing, 1925, Vol. II, pp. 1098, 1255, 1246.

<sup>3</sup> Ibid., 1929, Vol. I, p. 536.

<sup>4</sup> Michigan Senate Journal, Robert Smith Co., Lansing, 1941, Vol. II, pp. 1001, 1590.

was small. Without any regulation or state sanction, it is doubtful that many persons would entrust their savings to a credit union.

Further, in order to pay a competitive dividend and interest of 5 to 6 percent annually, income would have had to be sufficiently high to pay the modest expenses as well as interest and dividends. Borrowers would have to charge about 1 percent a month. This level was above the interest rate sanctioned by the Michigan small loan law, Act 228, P. A. 1915, amended 1921.<sup>1</sup>

In 1925, Michigan enacted Act 284, P. A., Section 1 of which makes it unlawful for any individual person or unincorporated association of individuals to engage in the business of banking such as accepting deposits or making loans.<sup>2</sup>

After this legislation, it became impossible for a credit union to develop unless a special credit union act were adopted, since it would have been difficult for them to raise sufficient capital and command sufficient knowledge of banking to obtain a banking charter under the requirements of Act 205, P. A. 1887.<sup>3</sup>

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<sup>1</sup> Roger S. Barrett, Compilation of Consumer Finance Laws, National Consumer Finance Association, Washington, D. C., 1952, p. 296.

<sup>2</sup> Act 284, P. A. 1925, State of Michigan, State Banking Department, Lansing, Section 1.

<sup>3</sup> Act 205, P. A. 1887, State of Michigan, State Banking Department, Lansing, Section 1.

With the passage of the Michigan Credit Union Act, credit unions, after a slow start, began to expand very rapidly. The slow start of credit unions in Michigan was due to the newness of this type of institution and to the depression years when few people had funds to place in any savings institution. The period of the "loan shark" had just passed and the people were skeptical about placing their funds in an untried institution. However, with a few years' experience, and a record of few liquidations in the depression, faith in the credit union expanded as did the credit unions. At the end of 1933, forty state-chartered credit unions were in operation in Michigan with assets of \$652,449, seven thousand two hundred fifty-nine members, and \$487,999 in loans outstanding.<sup>1</sup>

When the United States entered World War II at the end of 1941, state-chartered credit unions in Michigan numbered 176, with a combined membership of 67,336, loans outstanding of \$6,993,853, and total assets of \$10,750,835.<sup>2</sup> During the year of 1941, these credit unions made total loans of \$10,037,446 to 32,581 borrowers

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<sup>1</sup> Consolidated Statement and List of Credit Unions, Michigan State Banking Department, Lansing, 1937-1953.

<sup>2</sup> Ibid.

for an average loan of \$209. There were 6,184 depositors with an average deposit of \$99, and the average shareholding amounted to \$138 per member.<sup>1</sup>

During the war the credit union movement was slowed down, and membership fell off. However, with the cessation of hostilities, the upward trend was resumed with far greater rapidity. At the end of 1953, membership had grown to 164,627, with 235 state-chartered credit unions operating in Michigan, with total assets of \$77,979,508 and loans outstanding of \$57,708,289.<sup>2</sup> During the year of 1953, these credit unions made 158,807 loans amounting to \$63,-477,170 for an average loan of \$399. Depositors numbered 2,562 with an average deposit of \$227 while shareholdings amounted to an average of \$395 per member. Total deposits were \$581,858, while total value of shares held by members amounted to \$65,143,062<sup>3</sup> (see Tables I, II, and III).

The passage of the Federal Credit Union Act encouraged the creation of more credit unions. Soon federal-chartered credit unions surpassed the state-chartered unions in Michigan in both rate of

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<sup>1</sup> Ibid.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.

TABLE I  
DEVELOPMENT OF STATE-CHARTERED CREDIT UNIONS  
IN MICHIGAN, 1933-1953

Year	No. of Unions	No. of Unions Report- ing	Loans Outstanding	Assets
1933	40	40	\$ 487,999	\$ 652,449
1934	51	51	635,251	836,868
1935	73	73	1,206,448	1,350,578
1936	109	109	1,767,978	2,341,506
1937	137	137	2,806,958	3,290,376
1938	139	139	3,576,407	4,634,077
1939	163	163	5,215,272	6,720,069
1940	162	162	6,330,312	8,943,037
1941	176	171	6,993,853	10,750,835
1942	172	165	5,022,001	11,464,737
1943	165	164	4,491,699	12,742,085
1944	160	157	4,854,041	14,614,933
1945	154	153	5,189,139	16,566,082
1946	148	147	7,938,974	19,215,859
1947	150	150	11,846,818	23,544,913
1948	158	158	18,057,674	29,253,233
1949	161	159	24,154,321	36,049,580
1950	165	165	29,694,887	42,344,111
1951	171	170	32,643,182	48,869,769
1952	177	174	43,170,861	62,296,415
1953	235	210	57,708,289	77,979,508

Source: Compiled from Consolidated Statement and List of Credit Unions, State Banking Department, Lansing, 1938-53.



TABLE II  
DEVELOPMENT OF FEDERAL-CHARTERED CREDIT UNIONS  
IN MICHIGAN, 1936-1953

Year	No. of Unions	No. of Unions Report- ing	Loans Outstanding	Assets
1936	50	41		
1937	54	44	\$ 318,346	\$ 413,904
1938	57	50	339,511	482,393
1939	66	53	537,673	736,278
1940	86	73	1,005,983	1,670,398
1941	107	90	1,629,255	3,086,334
1942	110	84	1,133,479	3,643,534
1943	91	79	1,005,442	4,377,185
1944	93	84	1,127,045	5,007,531
1945	94	87	1,200,409	4,699,311
1946	99	93	2,142,375	5,689,292
1947	112	100	3,735,697	7,775,024
1948	123	117	6,127,016	10,402,563
1949	163	157	8,072,050	12,902,638
1950	220	214	12,765,268	18,805,332
1951	297	281	17,622,875	27,168,165
1952	388	369	28,134,389	42,796,951
1953	462	454	48,574,467	66,163,647

Source: Monthly Labor Review, United States Department of Labor  
U. S. Government Printing Office, Washington, Vol. 69, No.  
3, September, 1949, p. 279; Vol. 76, No. 2, February, 1953,  
p. 155.

TABLE III  
RELATIVE DEVELOPMENT OF CREDIT UNION MEMBERSHIP  
IN MICHIGAN, 1933-1953

Year	Federal		State	
	Unions Report- ing	Members	Unions Report- ing	Members
1933			40	7,259
1934			51	9,688
1935			73	14,840
1936	41	5,251	109	23,018
1937	44	8,706	137	30,510
1938	50	10,189	139	36,358
1939	53	14,295	163	50,659
1940	73	23,869	162	59,664
1941	90	38,872	171	67,336
1942	84	36,619	165	64,517
1943	79	42,434	164	63,702
1944	84	49,155	157	65,165
1945	87	44,793	153	63,840
1946	93	51,157	147	69,673
1947	100	61,715	150	79,880
1948	117	74,330	158	92,354
1949	157	82,973	159	102,561
1950	214	113,391	165	118,484
1951	281	143,977	170	130,482
1952	369	192,471	174	143,814
1953	454	246,476	210	164,627

Sources: State-Chartered--Compiled from Consolidated Statement and List of Credit Unions, State Banking Department, Lansing, 1938-53. Federal-Chartered--Monthly Labor Review, United States Department of Labor, U. S. Government Printing Office, Washington, Vol. 69, No. 3, September, 1949, p. 279; Vol. 76, No. 2, February, 1953, p. 155.

growth and aggregate membership. At the end of 1953 there were 454 federal-chartered credit unions in Michigan with assets of \$66,-163,647, loans outstanding of \$57,708,289, and membership of 246,476 (see Tables I, II, and III, and Figures 1 and 2).

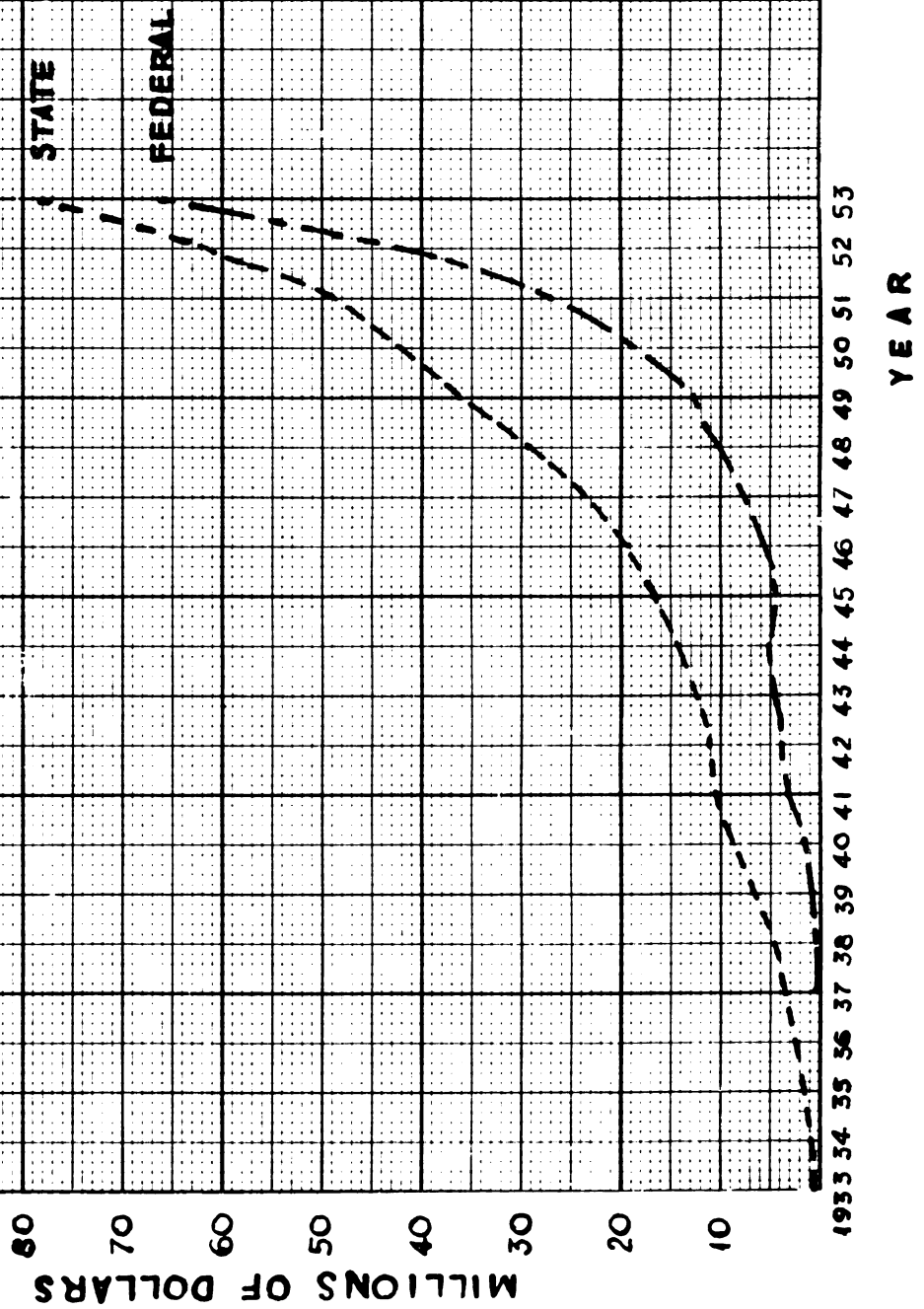
Since the primary purpose of this investigation is to determine if the existing regulation by federal and state authorities of credit unions in Michigan is adequate, I shall limit further discussion of credit unions to the following questions:

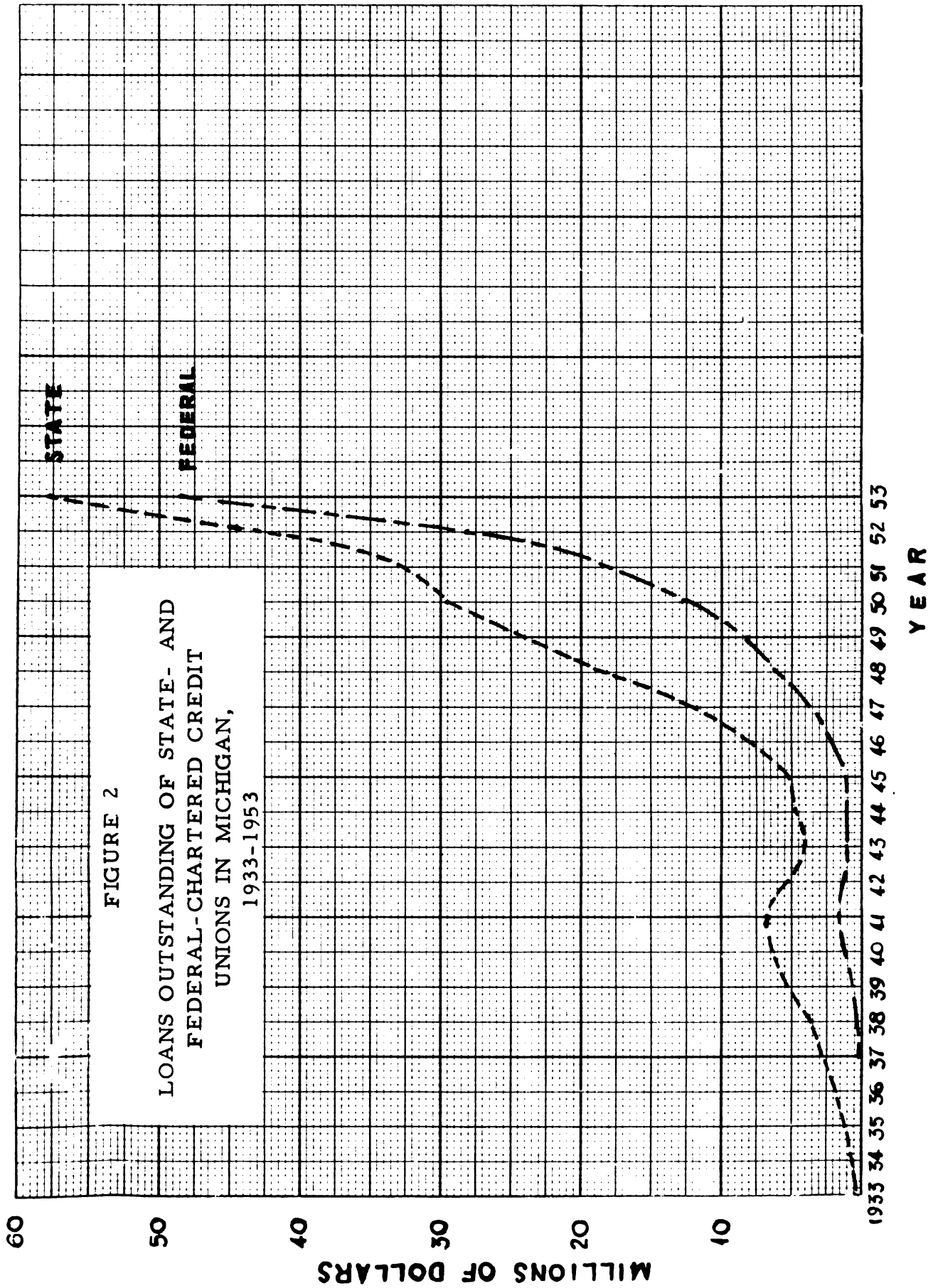
1. Is the existing legislation adequate to provide sufficient protection to credit union depositors, without stifling their development?
2. What has caused credit union liquidations in the past, and has this been the result of a lack of necessary legislation?
3. How does the existing credit union legislation compare with that which governs other similar types of institutions?
4. Is there a need for a uniform credit union code such as those in operation in other similar types of institutions?

Because the Michigan Credit Union Act is of an earlier date than the Federal Credit Union Act, and would logically seem to be more in need of revision, primary emphasis will be on the discussion of Michigan-chartered credit unions. However, important areas of the federal credit union operations will be included.

FIGURE 1

TOTAL ASSETS OF STATE- AND FEDERAL-CHARTERED  
CREDIT UNIONS IN MICHIGAN, 1933-1953





No doubt there are many other aspects of the credit union movement that are of equal importance and equally deserving of further investigation, as those listed. However, one is limited in the scope of a study and one must select those areas which seem to him to be in most need of study.

## CHAPTER II

### PROTECTION OF MEMBERS' FUNDS

#### Membership and Capital

Directors of the credit union determine the eligibility of membership. Persons allowed to join must subscribe to at least one share of stock, the par value of which must not exceed ten dollars for Michigan-chartered unions and five dollars for federal-chartered unions, and which may be purchased in installments of twenty-five cents each month.<sup>1</sup> Thus it is provided that there shall be no financial barriers to becoming a member. The stock of the credit union is not like that of a stock in a business corporation. The purchases of stocks by credit union members may be looked upon as deposits in a savings bank.<sup>2</sup> The money belongs to the member and he has the right to withdraw it at any time, or if needed, the credit union may call for a sixty-day notice of intent

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<sup>1</sup> Model By Laws for State Chartered Credit Unions, Michigan Banking Department, Lansing, Article II, Section 1.

<sup>2</sup> Bergengren, Credit Union North America, op. cit., p. 140.

to withdraw. However, this notice of intent to withdraw is only used in case of an emergency.

After a member of a state-chartered credit union has purchased at least one share of stock he may deposit funds with the credit union in a savings account, or he may continue to make deposits through the purchase of additional shares of stock.<sup>1</sup> Federal-chartered credit unions cannot accept deposits.

A Michigan-chartered credit union may also borrow from any source a total sum not to exceed 50 percent of its assets.<sup>2</sup> This compares with the federal provision that the credit union may borrow from any source an aggregate amount not exceeding 50 percent of its paid-in and unimpaired capital and surplus.

#### Loans to Members

A credit union, Michigan- or federal-chartered, may loan only to members or to other credit unions; however, the loan must be for a provident or productive purpose.<sup>3</sup> At least a majority of the members of the credit committee must pass judgment on all

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<sup>1</sup> Michigan Credit Union Act, op. cit., Section 5.

<sup>2</sup> Ibid., Section 4.

<sup>3</sup> Loc. cit.



loans and in order for a loan to be granted, approval of the above-mentioned majority must be unanimous.<sup>1</sup>

There are several limits on the lending activities of Michigan-chartered credit unions. First, in addition to any and all security which may be required, each and every loan or other extension of credit shall be evidenced by the promissory note of the borrower.<sup>2</sup> Second, unsecured loans shall not exceed \$400.00.<sup>3</sup> Third, secured loans, other than real estate loans, shall not exceed \$750.00, or 10 percent of the unimpaired capital of the credit union, whichever is greater: Provided, however, that no such loan shall exceed \$10,000.00.<sup>4</sup> Fourth, loans secured by first liens on improved real estate shall be made on a basis not exceeding 70 percent of the appraised valuation thereof, as certified by a qualified appraiser in writing, and no real estate loan shall exceed 10 percent of the unimpaired capital of the credit union. Such loans shall have a maturity not exceeding ten years and shall be repayable in at least monthly installments providing amortization of at least 4 percent of the principal sum annually.

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<sup>1</sup> Ibid., Section 10.

<sup>2</sup> Loc. cit.

<sup>3</sup> Loc. cit.

<sup>4</sup> Michigan Credit Union Act, op. cit., Section 9.

Loans secured by the Federal Housing Administration or guaranteed by the Veterans' Administration shall be exempt from requirements as to maturity and appraised value.<sup>1</sup> Fifth, the total amount of all real estate loans, including FHA and VA loans, shall at no time exceed 33-1/3 percent of the unimpaired capital of the credit union.<sup>2</sup> Lastly, the unsecured indebtedness of a member shall not exceed in the aggregate the amount fixed by the unsecured loan limit. The secured and/or unsecured indebtedness of a member, including liability as a comaker, endorser, guarantor, or otherwise, shall not exceed, in the aggregate, the amount fixed as the secured loan limit.<sup>3</sup>

The Federal Credit Union Act is much more restrictive than the Michigan Credit Union Act in respect to loans. Federal credit unions may only make loans to members with maturities not exceeding three years. Further, no loan may exceed 10 percent of the union's paid-in and unimpaired capital and surplus, or \$400, whichever is larger.

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<sup>1</sup> Ibid., Section 8.

<sup>2</sup> Loc. cit.

<sup>3</sup> Model By Laws for State Chartered Credit Unions, op. cit., Article XII, Section 8.

## Reserves

Both the federal and Michigan credit union acts provide that all entrance fees, fines (which may be provided by the by-laws for failure to make repayments on loans and payments on shares when due), and each year, before the declaration of a dividend, 20 percent of the net earnings, shall be set aside as a reserve fund, which shall be kept liquid and intact and not loaned out to members, and shall belong to the union to be used as a reserve for bad loans and not to be distributed except in case of liquidation. Loans which are delinquent and loans which are otherwise uncollectable may be charged to the reserve fund upon proper action of record by the board of directors.<sup>1</sup>

While Michigan-chartered credit unions must transfer 20 percent of their net earnings each and every year to the reserve fund, The federal act provides that when the reserve fund shall equal 10 percent of the total amount of the members' shareholdings, no further transfer of net earnings shall be required except as may be needed to maintain this 10 percent ratio.

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<sup>1</sup> Ibid., Article XV, Section 3.

All credit union bills, including the Michigan act, provide that, in the event of voluntary dissolution, no amount may be transferred from the reserve fund to undivided earnings for the distribution to stockholders, which would bring the reserve balance below that of outstanding loans.<sup>1</sup>

#### Regulation by State or Federal Authority

Credit unions chartered in Michigan are under the supervision of the Commissioner of the State Banking Department. They must report to him at least annually on or before the thirty-first day of December, on blanks supplied by him for that purpose. Additional reports may be required.<sup>2</sup> The credit unions must be examined at least annually by the Bank Commissioner, except that, if a credit union has assets of less than twenty-five thousand dollars he may accept the audit of a practicing public accountant. Failure to file reports when due results in the credit union being compelled to pay the state five dollars for each day of its delinquency.<sup>3</sup>

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<sup>1</sup> Ibid., Section 7.

<sup>2</sup> Michigan Credit Union Act, op. cit., Section 6.

<sup>3</sup> Ibid.

If the Bank Commissioner determines that the credit union is violating the provisions of the credit union act, or is insolvent, the commissioner may serve notice to the credit union of his intention to revoke the certificate of approval. If the violation continues for fifteen days or more, the commissioner may revoke the credit union certificate and take possession of the business and property of the credit union and maintain possession until the credit union may be permitted to continue business or is liquidated.<sup>1</sup>

Federal-chartered credit unions are under the supervision of the Director of the Bureau of Federal Credit Unions, in Washington. Provisions regarding examinations, fines, and insolvency proceedings are the same as those mentioned above, with the exception of examination fees, which will be discussed in the next section of this study.

### Supervision

All credit unions, at their annual meeting, have their members, each of whom is entitled to one vote, elect a board of directors of not less than five, a credit committee of not less than three, and a supervisory committee of three. The directors elect from their

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<sup>1</sup> Ibid.

own number a vice-president, a president, treasurer, and clerk, of whom the last two named may be the same individual.<sup>1</sup>

The directors have general management of the affairs of the credit union. Directors of state-chartered credit unions act on applications for membership, determine interest rates on loans and deposits, declare dividends, and declare maximum loans to be made without security, and the maximum shareholdings of an individual. The treasurer is the only officer who may be compensated for his services. Directors of federal-chartered credit unions are charged with presiding at all meetings of the members, control of the credit union's funds, securities, and all other assets, making required reports and enforcing the credit union act.

#### Comments on Protection of Members' Funds

Membership and capital. The limitation of membership to fellow employees, to members of the same church, lodge, labor union, or other organization, or to neighbors in a community group, and the further limitation that loans may be made only to members, results in the establishment of social pressures on the borrowers who otherwise might be thoughtless or dilatory in making repayments.

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<sup>1</sup> Ibid., Section 9.

However, there is a hidden weakness in the idea of a community of interests. Mutual dependency could easily result in failure when loans are not diversified, but are centralized in one common unit. A credit union organized by the workers of a single plant, with all loans and deposits concentrated in the hands of the workers in the plant, could suffer a failure if the plant should cease production. The reason is simple. The main source of income to repay loans and make deposits will cease to exist and at the same time the members would be reducing their deposits and cashing in their shareholdings.

Of course, if the production stoppage were a long one, earnings would be reduced and consequently less funds would be paid into the reserve account. At the time when members would most need funds, or their deposits, they would be unable to get them. Further discussion of this point will be considered under the topic of loans.

The maximum number of shares which may be held by any one person is fixed from time to time by the board of directors.<sup>1</sup>

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<sup>1</sup> Model By Laws for State Chartered Credit Unions, op. cit.,  
Article XII, Section 8.

This discretionary power is difficult to administer. If an exceedingly high limit is set, a credit union may become financially dependent on a small group of shareholders whose views may carry far more influence than their numerical number of votes, of one per person. They would have this additional power because they could ruin the credit union if they withdrew their capital. If the limit is too low, however, the incentive to save in the credit union is weakened. Higher limits may bring in more capital, thus permitting the dividends on shares to be reduced unless this added capital is wanted for loans. A statutory percentage limit could eliminate this problem.

Loans. In regard to loans, the present Michigan Credit Union Act would seem to be adequate to protect depositors. Two features of the act, however, could be safely revised. Because of the risks due to changing market values, loss of liquidity of investment and unfortunate experience, the Michigan Credit Union Act limits the total amount of all real estate loans, including FHA and VA loans, to 33-1/3 percent of the unimpaired capital of the credit union.<sup>1</sup> A further provision could require that a certain percentage of real estate loans,

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<sup>1</sup> Ibid., Section 8.



perhaps 20 percent, be of VA and FHA insured loans. There is little doubt today as to the marketability of the VA and FHA loans, and the above requirement would be of great value during recession of business activity.

The main problem regarding loans, as stated before, is the need for diversification. Credit unions have often been called "fair-weather" institutions, meaning that as long as business conditions are good, the credit union will prosper. However, when business conditions are bad, the credit union will fail. In support of their using the "fair-weather" label, credit union critics make reference to the following statistics. During the year of 1953, all federal credit unions in the United States made 2,475,134 loans with a total value of \$959,897,119.<sup>1</sup> Of these, 2,338,538, or 94.4 percent of the loans, with a value of \$888,459,283, or 96.2 percent of the total loan value, were made to occupational group credit unions.<sup>2</sup> Within the occupational credit union group, six industries, which are tied directly to the swing of the business cycle, such as auto production, chemicals,

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<sup>1</sup> 1953 Report of Operations, Federal Credit Unions, U. S. Department of Health, Education and Welfare, Washington, 1953, p. 27.

<sup>2</sup> Ibid.

construction, machine production, et cetera, account for 24.9 percent of the occupational loans made and for 23.2 percent of the total occupational loan value.<sup>1</sup>

It is felt that industries such as the six mentioned will in times of depression be unable to maintain production, thereby making it impossible for credit union members to repay loans, while forcing other members to withdraw their savings to meet current expenses.

It is impossible, on the basis of existing data to substantiate or refute the above argument. Nevertheless, much of the plausibility of the above argument could be removed if credit unions could diversify their loans. The argument that credit unions must only loan to their members, since this in fact seems to guarantee the loan being repayed, due to social pressure exerted on the borrower from other members who of course wish to protect their investment, is valid to only a very limited extent. If one looks at the record of a bank or a personal finance company, which has little common interest with its borrowers, one will see that there is as small a percentage of loan failures as that of credit unions. People do not simply repay loans because they have a vested interest in the organization

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<sup>1</sup> Ibid.

from which they borrow. There are many groups that are too small to organize a profitable credit union themselves, that would be happy to have use of credit union funds, thereby servicing the borrower with low rates of interest, and further insuring the solvency of the credit union by diversifying its loans.

Credit union officials pride themselves on being noted that their criteria of credit union operation is, "We believe that 99 percent of the people are honest." This 99 percent refers to all people, not just to 99 percent of the credit union's members, and therefore nonmembers as well as members can be expected to be honest and repay their loans. Certainly strict rules would have to be established to cover nonmember loans to avoid the possibility of officials loaning funds to organizations or individuals in which they have a vested interest.

Michigan credit unions have a special need for a diversification of their loans over that of other credit unions. This is due to the extreme importance of the automotive industry as an employer in Michigan. The economy of Michigan is tied very directly to the employment in the automotive industry, and likewise the soundness of credit unions in Michigan is tied to the level of employment in the automotive industry, as can be seen from the following figures.

At the end of 1953, there were seventy-seven credit unions in Michigan with membership of one thousand or more persons.<sup>1</sup> Of these, thirty-three, or 48.5 percent, were credit unions established in plants which either produced automobiles directly, or were primary suppliers of automotive firms. These credit unions comprised 22.7 percent of the total credit unions in Michigan. These same thirty-three credit unions had loans outstanding of \$18.5 million, or 30.4 percent of the loans of credit unions with one thousand or more members, and 17.6 percent of the loans outstanding of all credit unions in Michigan.

The above figures clearly indicate the need for greater diversification of loans by Michigan credit unions. Any long stoppage of production by the automotive industry would cut off the ability of members to repay at least 17.6 percent of the loans outstanding, not to mention the secondary results upon such firms as department stores, retail food stores, auto servicers, and other firms dependent upon the income of the auto workers as their source of income. Any employment insurance benefits received would be needed for food and shelter expenses, with little if any available for repayment of loans.

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<sup>1</sup> All figures compiled from 1st Annual Statistical Yearbook, Michigan Credit Union League, Detroit, 1953.

It must not be assumed, from the foregoing, that credit unions will collapse with every downturn of the business cycle or interruption of production. A well-run credit union is able to weather almost any economic crisis. The case of the Wyandotte Chemicals Employees' Credit Union is given here as an example of a credit union that was placed under great pressure, yet survived.

At eleven o'clock on the night of January 30, 1955, members of Local 12270 decided to strike, resulting in the shutdown of all plants and the immediate loss of employment for 3,700 hourly paid employees, 90 percent of whom were members of the Wyandotte Chemicals Employees' Credit Union.<sup>1</sup> This work stoppage meant that over 60 percent of the credit union's members were unemployed.

The Wyandotte Chemicals Employees' Credit Union, under the able leadership of David Arsenault, Treasurer and Manager, has grown to be one of the outstanding credit unions, both in size and more important in providing service to its members. The officials of the credit union were able to foresee the strike and realized that the most important reaction to prevent was panic. Therefore, the following letter was sent to all striking employees:

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<sup>1</sup> David Arsenault, Treasurer-Manager, Wyandotte Chemicals Employees' Credit Union, oral communication.

Dear Member:

Due to the controversy between Local 12270 and Wyandotte Chemicals Corporation, resulting in the shutdown of all plants, it will be necessary for your credit union to adopt the following policy:

1. Business will be conducted as usual. There will be no change in office procedures or hours whatsoever.
  2. All mortgage loan applications that have not been placed in the hands of our attorney for processing will be held in abeyance until the controversy is over.
  3. We will continue to make personal loans for provident and productive purposes.
  4. For the duration of the controversy, interest only will be transferred from savings.
  5. All that we ask is that, if you are financially able to pay on your loan, do so; it will be to your advantage. If you cannot pay on the principal, pay your interest. If the controversy lasts too long, and no principal or interest can be paid, it can be made up when you return to work.
  6. We are ready and willing to serve you, please feel free to come in and talk to us.
- Very truly yours,  
David Arsenault  
Treasurer-Manager

The only real change in the credit union's policies was to withhold action on all real estate loan applications which were not already in the process of adoption.

At the time of writing, the strike had been on for eleven weeks. Throughout the period all operations of the credit union had been directed toward carrying the workers through the strike. Loans had been made, whenever sufficient reason for a loan had been established. All loans for luxury items had been refused. The policy on

loans had been to give loans for such items as grocery bills, house and automobile payments, emergency medical expenses, et cetera.

What effect has the strike had on the Wyandotte Chemicals Employees' Credit Union? Of course the strike has affected the credit union. But the effects have been held to a minimum by sound leadership. A comparison of important features of the credit union's financial statements of December 31, 1954, and of March 31, 1955, will yield some insight to the strike's effects.

	December 31, 1954 <sup>1</sup>	March 31, 1955 <sup>2</sup>
Total assets . . . . .	\$4,145,924	\$4,124,783
Loans--personal . . . . .	\$1,966,833	\$2,040,901
Loans--real estate . . . . .	\$1,493,910	\$1,520,093
Cash on hand . . . . .	\$ 265,013	\$ 129,880
Notes payable--to banks . .	\$ 0	\$ 50,000
Shares . . . . .	\$3,858,909	\$3,885,503
Members . . . . .	5,335	5,485
Borrowers . . . . .	2,781	2,849

It can be seen from the above statements that the strike has not had any large effect on the credit union. Personal loans are up 3 percent. Real estate loans are up less than 2 percent. Cash on hand has decreased. The one significant change has been the borrowing

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<sup>1</sup> Annual Financial Report to Shareholders, Wyandotte Chemicals Employees' Credit Union, Wyandotte, Michigan, 1954.

<sup>2</sup> David Arsenault, oral communication.

of \$50,000 from banks. On December 31, the total reserve fund was \$88,148.<sup>1</sup>

The credit union was in a very liquid position on March 31, 1955. How long the strike will last, no one can predict.<sup>2</sup> Likewise, how long the credit union can continue normal operations is impossible to predict. But as long as the credit union can function, it will continue to fulfill its obligations to its members, for which it was created, that of supplying its members with funds to overcome a crisis.

Reserves. As of December 31, 1953, Michigan state-chartered credit unions had reserves of \$2,457,546, against total assets of \$77,979,508.<sup>3</sup> Loans amounted to \$57,708,289, or 74 percent of the assets.<sup>4</sup> The reserves required by Section 17 of the Michigan Credit Union Act amounted to only 0.4 percent of the total assets.<sup>5</sup> The question arises as to whether or not this is sufficient. A comparison of the credit union reserve requirements with that of other financial institutions may shed light on this question.

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<sup>1</sup> Ibid.

<sup>2</sup> The strike lasted 88 days.

<sup>3</sup> Abstract of Reports of Credit Unions, State Banking Department, Lansing, December 31, 1953.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.



Savings and loan associations are required to have at least 6 percent of their assets in reserves, which consists of cash on hand and government bonds.<sup>1</sup> Michigan-chartered unions on December 31, 1953, had government obligations of \$8,996,537, cash on hand and in banks of \$5,920,514, and reserves of \$2,457,546, for a total of \$17,374,598, or 22 percent of their assets,<sup>2</sup> 16 percent greater than the minimum required of savings and loan associations.

A Michigan-chartered building and loan association is required to have reserves equal to 5 percent of its assets.<sup>3</sup> It has already been shown that the Michigan-chartered credit unions had reserves, cash, and government obligations far in excess of 5 percent of their assets at the end of 1953.

Commercial and industrial banks, chartered by the State of Michigan, must keep on hand or on deposit at all times with one or more legal depositories an actual net balance in cash payable on demand, to at least equal 12 percent of the amount of its total

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<sup>1</sup> Savings and Loan Fact Book, United States Savings and Loan League, Chicago, 1954, p. 55.

<sup>2</sup> Abstract of Reports of Credit Unions, op. cit., 1953.

<sup>3</sup> Act 50, P. A. 1887, Amended, State of Michigan, Secretary of State, Section 24.

deposits.<sup>1</sup> As of December 31, 1953, Michigan-chartered credit unions had deposits of \$581,858, and reserves against these deposits of \$2,457,546.<sup>2</sup> Reserves were five times greater than deposits. If we include government obligations and cash on hand, as reserves, it will raise the reserve ratio to 25 to 1, in favor of the reserves. The savings deposits are not covered by any type of savings insurance. There have been several attempts to have a bill introduced in Congress to provide insurance of credit union deposits by the federal government, as is done through the Federal Deposit Insurance Corporation for bank deposits. The credit unions, both state- and federal-chartered, have resisted these attempts on the grounds that the disadvantages of the government insurance outweigh any possible advantages. The increased control of a federal insurance agency, which is already thought of as being too bureaucratic and involved in too much red tape to reach a decision within a reasonable period of time, would reduce the powers of the credit unions which they now possess. Further, it is believed by the credit unions that the suggestion of an insurance of deposits has been advanced by the

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<sup>1</sup> Act 341, P. A. 1925, State of Michigan, Section 68.

<sup>2</sup> Abstract of Reports of Credit Unions, op. cit., 1953.

bankers' interests to increase the expenses of credit unions, and thereby remove some, if not all, of their competitive advantage which they enjoy over other lending institutions.

The Michigan Credit Union League is currently considering a proposal offered by a commercial insurance agency whereby the League would, upon notice of any sudden dissolution of a member credit union, guarantee the purchase of all the outstanding notes of the union at face value, so that the depositors could get their savings rapidly. The notes would be turned over to a league collection agency so that the outstanding loans could be repayed gradually.<sup>1</sup>

The shares of the credit unions are not insured, and are treated the same as corporate stocks, and the shareholders have the same rights as do corporate stockholders upon declaration of bankruptcy.

The argument is made that the banks and savings and loan associations can operate at a smaller reserve ratio because their deposits are insured by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation, respectively. But simply because a financial institution is insured by the federal

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<sup>1</sup> Robert Perrin, "State's Credit Unions Weathering Blow," Detroit Free Press, March 20, 1955, p. 8-A.

government does not remove the necessity of a sound liquidity position. Financial institutions must have a sound liquidity position in order to be insured.

The reserve requirement comparison has simply shown that as of December 31, 1953, Michigan credit union reserves were equal to the ratio as required by law for commercial banks and savings and loan associations if we include as reserves for credit unions, cash on hand and in banks, and government obligations.<sup>1</sup> The important consideration at this point is not what are the possible reserves, but what are the required reserves. Required reserves are the sole funds set aside to cover bad debts and to pay all obligations in case of failure. The credit unions were in a favorable liquidity position at the end of 1953, mainly due to their large holdings of government bonds and cash on hand. There is nothing to prevent the credit unions from increasing their loan funds by reducing these holdings of bond, and thereby reducing their liquidity position relative to other lending institutions.

Other financial institutions have a limit imposed upon their reserves in relation to their total assets, which prevents their granting

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<sup>1</sup> Commercial banks in Michigan, on December 31, 1953, had 40.5 percent of their total assets in government obligations, amounting to \$2,866,562,000.

loans or increasing assets, unless an adequate reserve fund is established. Credit unions, however, do not have any such limit imposed upon them, and as long as 20 percent of the net earnings each year are deposited in the reserve fund, they may continue to make loans while funds are demanded, and while funds are available. That this is inadequate protection for the funds of the depositors would seem to be evident to anyone familiar with the facts.

The present reserve requirement is often termed a "fair-weather paradox" requirement. The size of the reserve fund is, for all practical purposes, solely dependent on earnings, since it is required that 20 percent of the net earnings be placed in the reserve fund each year. It is believed that in periods of relative prosperity credit union members do little borrowing, and since the main source of earnings is the interest charged on loans, the reserve fund will be stable. During a period of recession, when members are borrowing a great deal and loans are being repayed, this then is the time when the reserve fund is supposed to be increased. The above theory would certainly seem to be logical. Yet a look at the credit union balance sheets quickly refutes this theory (see Tables I and II). It has been during the periods of greatest business activity that the loans have been made, and therefore the reserves increased. It is

during the boom periods that the credit union members, confident of continued prosperity and continuous employment, are willing to borrow money from their credit union to purchase autos, appliances, houses, et cetera, as happened during the boom years following World War II.

Of course, past experience is not a guarantee that with a serious recession the number of loans by credit unions would fall, and if they did not fall, but increased, the "fair-weather" reserve paradox could hold. Financial institutions must strive to be sound at all times, not only during periods of prosperity, but especially during periods of recession, when funds are most needed by the members. As long as the possibility of the "fair-weather" reserve paradox exists, statutory regulation of credit unions will not be effective. In place of the 20 percent of net earnings being required to be placed in the reserve fund, would not a minimum reserve requirement of a certain percentage of the assets solve the paradox? This would place a maximum loan limit on the credit union in relation to its assets and reserves, which would function in periods of prosperity and depression, to the protection of the credit union depositors. A reserve requirement of 8 to 10 percent of total assets, the reserve to consist of government obligations and cash on hand

and in banks, would give greater protection, without hurting the present credit union financial position. Along with the provision for a reserve requirement of a certain percentage of the total assets, there is a need for a limit to the size of the individual credit union reserve. Credit unions in many cases are being penalized and prevented from increasing their dividend payments by being required to pay 20 percent of their net earnings into a reserve fund, irrespective of how large the existing reserve fund has already grown.

Senate Bill 1248, introduced to the 68th Legislature of Michigan on March 8, 1955, by Senator Hittle, and sponsored by the Michigan Credit Union League, calls for a change in the reserve requirement, whereby 20 percent of the net earnings be set aside in the reserve fund, but when the reserve fund reaches 10 percent of the credit union's assets, no further transfer of net earnings be required except such amounts, not in excess of 20 percent of the net earnings, as may be needed to maintain the 10 percent ratio, be transferred.<sup>1</sup> This provision is a step in the right direction; however, the danger of insufficient reserves in the early years of a credit union's existence is not removed. The flat requirement of at least 10

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<sup>1</sup> Senate Bill 1248, 68th Legislature, Michigan, March 8, 1955, p. 9.

percent of the total assets, to be held in a reserve fund at all times, would provide a greater safeguard both in the early years when the credit union is just starting and in the later years when dividend payments become more and more important.

Further, although the 10 percent minimum may become a maximum in the eyes of credit union officials, the requirement is at least equal to reserve requirements which have been considered safe for other financial institutions.

Regulation by state or federal authority. Section 6 of the Michigan Credit Union Act requires that credit unions shall be examined at least annually by the State Banking Department, and for each annual examination the credit union so examined shall pay into the state treasury, to the credit of the general fund, the sum of twenty-five dollars.<sup>1</sup>

The State Banking Department has complete control over the credit unions and handles all matters pertaining to them such as audits, reports, and charter issuance. The only direct cost to the credit union for this service is the \$25 examination fee.

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<sup>1</sup> Michigan Credit Union Act, op. cit., Section 6.



A credit union examination requires two men to work approximately three days on each examination. The \$25 charge doesn't cover the costs of the examination.<sup>1</sup> The Federal Credit Union Act provides that the federal credit union pay each year a supervision fee in accordance with a graduated scale prescribed by regulation on the basis of assets as of December 31 of each preceding year.<sup>2</sup>

<u>Total Assets</u>	<u>Maximum Fee</u>
\$500,000 or less . . . . .	30 cents per \$1,000.
Over \$500,000 . . . . .	\$150 plus 25 cents per \$1,000 in excess of \$500,000.
Over \$1,000,000 . . . . .	\$275 plus 20 cents per \$1,000 in excess of \$1,000,000.
Over \$2,000,000 . . . . .	\$475 plus 15 cents per \$1,000 in excess of \$2,000,000.
Over \$5,000,000 . . . . .	\$925 plus 10 cents per \$1,000 in excess of \$5,000,000.

All such fees shall be deposited with the Treasurer of the United States, for the account of the Bureau, to be expended, by the Director for administrative and other expenses of supervision.<sup>3</sup>

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<sup>1</sup> Delmar C. Nagel, Deputy Commissioner, State Banking Department of Michigan, oral communication.

<sup>2</sup> Federal Credit Union Act, op. cit., Section 5.

<sup>3</sup> Ibid.

The current rate of federal credit union examiners is \$7.00 per man per day.<sup>1</sup>

The state banking department receives its funds by appropriation from the state legislature. Funds adequate to insure proper supervision of credit unions are often lacking.<sup>2</sup>

The federal credit union provision regarding supervision of credit unions is much more reasonable than the state act, and explains why data on federal credit unions are much more adequate than on state-chartered credit unions. There is no reason why credit unions should not pay the full costs of their examinations and other expenses incurred by the banking department in providing supervision of them.

A state provision patterned after the federal provision regarding regulation as to examination, reports, et cetera, is needed to insure adequate inspection of credit union operations. By allowing the commissioner of the State Banking Department to determine the supervision fees, the funds collected will have some relation to the cost of the supervision. Those receiving the benefits of the

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<sup>1</sup> Delmar C. Nagel, oral communication.

<sup>2</sup> Ibid.

supervision will be the persons paying for it, rather than diffusing the cost to the general taxpayers, many of whom are not credit union members, and the Banking Department will be assured of funds to properly inspect, regulate, and report on the credit union activities. While competing financial institutions might benefit from improved credit union audits, it would be no more so than have the credit unions in the past from the strict audits of these institutions.

One of the soundest sections of Senate Bill 1248, sponsored by the Michigan Credit Union League, Section 6, attempts to solve this problem by providing for the determination of supervision fees on the basis of the size of the total assets of the credit union examined, patterned somewhat after the provisions of the Federal Credit Union Act.<sup>1</sup> The bill provides that the examination cost be computed as follows: seven cents per \$100 or fraction thereof on the first \$1,000,000 of total assets; six cents per \$100 or fraction thereof on the second \$1,000,000 of total assets; five cents per \$100 or fraction thereof on the third \$1,000,000 of total assets; four cents per \$100 or fraction thereof on the fourth \$1,000,000 of total assets; three cents per \$100 or fraction thereon on the next \$5,000,000 of total

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<sup>1</sup> See page 45 of this study.

assets; one cent per \$100 or fraction thereof on all assets in excess of \$10,000,000, or \$6.00 per examiner-hour, whichever is lower. Any credit union so examined shall pay a minimum examination fee of the sum of \$25.00. If the above method of determining examination fees were adopted, the costs of examining the credit unions would be placed on a more equitable basis, and credit unions with assets of over a million dollars would not be paying the same amount as credit unions with assets of less than ten thousand dollars.<sup>1</sup>

The one remaining problem regarding proper regulation of credit unions is the fact that the funds obtained through examining and chartering the state-chartered credit unions are not placed aside for the sole purpose of regulating credit unions, but are placed in the general fund, for the legislature to determine how much should be allotted for the regulation of credit unions. With the rapid growth of credit unions in Michigan and the increased amount of effort required to examine them, some thought should be given to the possibility of establishing a separate governing body apart from the State Banking Department, to be solely concerned with the regulation of credit unions in Michigan. If the suggested method of examination

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<sup>1</sup> Total assets of the Detroit Teachers Credit Union on December 31, 1953, were \$18,506,321.

fee determination were adopted, the funds from this activity alone should be sufficient to cover most of the costs of operating such a department, and the grant from the general fund could thereby, to some extent, be reduced, saving the ordinary taxpayer from entirely supporting the credit union regulatory agency. A separate credit union agency could devote more time to the problems of the credit unions, and to the examination of their activities, to insure adequate protection to the depositors and shareholders.

Supervision. Credit unions are thoroughly democratic organizations. Each member has one vote regardless of the number of shares he may own. General meetings of the membership must be held at least once a year at which time members elect a board of directors who choose the officers. I have already cited the extensive powers enjoyed by the officers.

To protect the credit union members, all officers are bonded, and it is provided that no director or officer, or member of the credit committee, may borrow from the credit union beyond the amount of his or her holdings in shares or deposits, nor may he or she endorse, cosign, or guarantee for borrowers. This would seem to provide a great deal of protection. Yet, the danger does not seem to be from embezzlement but rather from incompetency.

Credit unions have no program for training of credit union officers in the management of loans and investments. Many of the officers come into contact with financial transactions which they have little if any knowledge of. There is no doubt that many of the existing credit union officers are competent, as can be seen from the fine record of the credit unions. Nevertheless, there is little doubt that the officers gained much of their competency, by on-the-job training, while handling large and foreign transactions. Certainly improvement can be made regarding this condition.

Incompetency of officers may hurt the credit union in two ways. First, due to their incompetency, officers may tend to be overly conservative. Fearing for the solvency of the credit union, directors may turn down many safe loan applications, thereby failing to serve the credit union members, and at the same time reducing the credit union's earnings.

Second, and equally important, officers, while meaning to do well, but due to their lack of knowledge of the loan and investment business, may make unsafe loans and investments. The supervisory committee is given the job of examining the credit union affairs at least quarterly, to determine the efficiency and soundness of its operations. But the supervisory committee is as uninformed as are the other officers.



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A reasonable solution to the problem of insuring the competency of credit union officers would be for the Michigan Credit Union Act and the Federal Credit Union Act to be amended to provide for a training course and an examination for the officers, upon completion of the course. A possible list of topics to be studied could be:

1. The provisions of the Michigan Credit Union Act and the Federal Credit Union Act.
2. What is a financially sound credit union position.
3. How to determine the safety of a loan.
4. How to prepare credit union financial reports.
5. What are adequate reserves.

The Michigan Credit Union League currently provides an educational program for its members, consisting of week-end institutes, chapter clinics, and correspondence courses, to acquaint its members with the proper operational procedures of a credit union. Field representatives of the League visit newly chartered unions periodically, to help them overcome any problems they may be encountering. The League, whose members include all but forty-two credit unions in Michigan, has done much to improve the efficiency of the credit union officers. However, the League is purely a trade association financed by the dues collected from the credit unions composing it.



There is no way the League can help a credit union that does not want help. Therefore, examination of credit union officers, required by law, would insure that each and every credit union officer attained a minimum of proficiency in his job.

Funds for the above program, if the credit unions were convinced of its desirability and usefulness, could be obtained by a small tax, to be paid by the credit unions. Credit unions are currently paying dues to the League for much the same purpose and should have no objection to paying for this service by a tax, which would remove the burden from the League.

## CHAPTER III

### CREDIT UNION LIQUIDATIONS

It is the purpose of this chapter to examine both federal- and state-chartered credit union liquidations to discover the reasons for liquidation in order to see if any of the liquidations could have been prevented by improved legislation. Voluntary and involuntary liquidation of a credit union imposes a hardship upon the members in that the assets are often seized or frozen, and a long period of time may pass before a member can receive his funds.

The word "liquidation" as used in this study means a final surrender of charter. It includes mergers or conversions to state or federal charter and revocations of the charter of a credit union which has never done any business. This study deals only with those cases in which the final outcome of the liquidation process has been determined. It does not include credit unions which are under suspension or in the process of liquidation.

Liquidations of both state- and federal-chartered credit unions will be discussed. The section dealing with the federal credit unions, however, will for the most part be confined to a discussion of

liquidation on a national level only, since information of individual state liquidations is very scanty. Discussion of the state-chartered credit unions will deal only with the liquidations of credit unions chartered in Michigan, to discover any possible improvements that could be made in the Michigan Credit Union Act.

### Federal Credit Union Liquidations, 1935-1953

From the passage of the Federal Credit Union Act in 1934 to the end of 1953, there were organized 9,096 federal credit unions. Of this number, 2,240, or 22 percent of the total, were liquidated.<sup>1</sup>

Historically, the record of the federal credit union liquidation from 1935 through 1953 has been very good. The rate of liquidation was low in the early years of the system, rose sharply from 1943 to 1948, due to wartime controls on credit, and then declined for a few years, before starting to rise rapidly again during the Korean War, as can be seen in Table IV. Statistical analysis reveals that the small credit unions, measured by the number of members and shareholders, predominated in liquidations (see Table V). All age

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<sup>1</sup> 1953 Report of Operations Federal Credit Unions, U. S. Department of Health, Education and Welfare, Bureau of Federal Credit Unions, Washington, p. 15.

TABLE IV

NUMBER OF CHARTERS ISSUED AND CANCELED BY YEARS,  
AS OF DECEMBER 31, 1934-1953

Year	Number of Charters		Percentage of Total Credit Unions
	Granted	Canceled	
1934	78		
1935	828		
1936	956	4	0.02
1937	638	69	2.76
1938	515	83	2.75
1939	529	93	2.62
1940	666	76	1.81
1941	583	89	1.86
1942	187	89	2.04
1943	108	321	7.20
1944	69	285	6.70
1945	96	185	4.58
1946	157	151	3.82
1947	207	159	4.00
1948	341	130	3.24
1949	523	101	2.44
1950	565	83	1.79
1951	533	75	1.46
1952	692	115	1.87
1953	825	132	1.92
Total	9,096	2,240	

Source: Bureau of Federal Credit Unions, Annual Report of Operations (1937-1953).

TABLE V

NUMBER, MEMBERSHIP, AND SHARE BALANCES OF FEDERAL  
CREDIT UNIONS LIQUIDATED, 1936-1953

Year	Totals in Liquidations		
	Unions	Members	Balances
1936-41	414	19,807	\$ 471,877
1942	89	5,777	192,815
1943	321	24,446	964,172
1944	285	24,439	930,745
1945	185	24,607	1,030,845
1946	151	18,499	1,106,742
1947	159	15,487	891,339
1948	130	13,505	912,919
1949	101	17,815	868,454
1950	83	9,013	723,250
1951	75	5,580	410,434
1952	105	12,008	1,235,313
1953	109	12,830	1,688,700
Total	2,054	203,813	\$11,427,603

Source: Bureau of Federal Credit Unions, Annual Report of Operations (1937-1953).

groups were fairly evenly represented. Classified by type of occupational, associational, and residential credit union, the percentages liquidated were 73.8 percent, 21.6 percent, and 4.6 percent, respectively. Liquidations in the occupational area ranged from 9.5 percent among telephone workers' credit unions to 70 percent in credit unions organized in hotels and restaurants.<sup>1</sup>

The liquidated credit unions paid to shareholders at liquidation 104 percent of total shareholdings for a net gain of \$456,981; 1,640 credit unions paid more than 100 percent; and 414 credit unions paid less than 100 percent of the amount due.<sup>2</sup> Total losses in liquidation were amazingly small, only \$129,048, or about 0.025 percent of the share balances in all credit unions at the end of 1953, an infinitesimally small percentage of the total amount entrusted to the care of federal credit unions since 1934.

Since 1934, credit unions in Michigan, operating under a federal charter, have grown steadily. At the end of 1953, 523 charters had been granted, of which sixty-one, or 11.6 percent, have been canceled. A yearly breakdown of charter issuance and cancellation is given in Table VI.

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<sup>1</sup> Ibid., p. 29.

<sup>2</sup> Ibid.

TABLE VI

NUMBER OF FEDERAL CHARTERS ISSUED AND CANCELED IN  
MICHIGAN, BY YEARS, AS OF DECEMBER 31, 1936-1953

Year	Number of Charters		Percentage of Total Credit Unions
	Granted	Canceled	
1936-43	114	24	21.8
1944	6	4	4.1
1945	6	5	5.1
1946	8	3	2.9
1947	14	1	0.9
1948	18	7	5.4
1949	42	2	1.2
1950	59	3	1.4
1951	81	4	1.3
1952	97	6	1.5
1953	77	3	0.6
Total	523	61	

Source: Bureau of Federal Credit Unions, Annual Report of Operations (1937-1953).

It is very difficult to attempt to explain the reasons for a credit union liquidation. Reasons reported by the examiners--and they are the chief source of this information--reflect the biases, the prejudices, or even the lack of interest of a harassed examiner.

In an attempt to clarify this topic, 351 liquidations were studied which took place in the years from 1948 through 1951, and the reasons were tabulated (Table VII). The years 1948 through 1951 were selected to avoid the influence of wartime credit controls on credit union activities, which in the past has been responsible for many credit union liquidations. The reasons listed must be accepted as accurate only to a degree: they must be qualified in so far as they reflect inadequacies in the examiner's reports.

It is evident from Table VII that slightly over one-third of the liquidations of these four years were due to factors over which the officers and members had little or no control. The moving of a plant or the closing of a plant in which the credit union exists necessarily means the liquidation of the credit union. This one factor accounts for 21.4 percent of all liquidations. The opposition of the employer, accounting for 13.4 percent of all liquidations, likewise makes it difficult or impossible for the credit union to continue in operation. There is very little in this area that legislation can help to overcome.



TABLE VII

ANALYSIS OF REASONS REPORTED FOR LIQUIDATIONS  
OF FEDERAL CREDIT UNIONS, 1948-1951

Reasons Reported	Credit Unions	
	No.	Pct.
1. Indifference of potential leaders and members . . . . .	140	39.8
2. Closing of plant or field of operation . . . . .	75	21.4
3. Opposition of employer . . . . .	47	13.4
4. Field of membership unsatisfactory . . . . .	39	11.1
5. Management and operating problems (internal friction) . . . . .	25	7.2
6. Heavy labor turnover . . . . .	15	4.3
7. Alternative thrift and loan service available . . . . .	8	2.3
8. Miscellaneous . . . . .	2	0.5
Total . . . . .	351	100.0

Source: John T. Croteau, Federal Credit Union Liquidations, 1935-1951, Journal of Business, University of Chicago, July, 1952, p. 199.

In regard to indifference of potential leaders and members, which accounted for 39.8 percent of the liquidations, constructive legislation could prevent this to some extent. The present Federal Credit Union Act provides that any seven or more natural persons who desire to form a federal credit union may do so upon application. This is hardly sufficient to insure that there is a need for a credit union and that there will be sufficient membership to maintain one. An amendment providing that there be a minimum of 100 persons desiring establishment of a credit union, although not insuring ability to sustain operation, would provide greater assurance than is currently provided. Any act which enables any seven persons to form an organization to handle funds of depositors, seems to place a great deal more trust in the inherent ability and honesty of the people applying for a charter, than can be judged wise on the basis of the information available. Charters have often been issued in the past, where there has been no real need or desire for a credit union, or where there has been little if any possibility of a credit union being successful.

The study of federal credit union liquidations has revealed little other useful information of the type needed for improving legislation except that there is a need for establishing some minimum

amount of credit union desirability before issuing charters. Although the number of liquidations may seem to have been large, the losses were surprisingly small--trivial in all but a few cases. Liquidations due to the inability of credit union officials could be reduced somewhat by the enforcement of a training program outlined earlier in this study.

It is safe to say that liquidation of federal-chartered credit unions has not been due primarily to any inherent weakness of the Federal Credit Union Act, but rather to factors operating outside the control of legislation. These factors tend to operate regardless of any attempts by legislation to stop them. The aim of legislation should be to reduce the harmful affects which these external factors may produce, through such provisions as:

1. Requiring a sixty-day advance notice of an employer of his intention to close or move his plant, whenever possible.
2. Establishing a level of fines to be levied against employers who discriminate against employees who join or foster the establishment of a credit union.

## Michigan-Chartered Credit Union Liquidations

The first legal credit union in Michigan was chartered by the State of Michigan on November 5, 1925.<sup>1</sup> From the passage of the Michigan Credit Union Act in 1925 to March 15, 1955, there were organized 459 state-chartered credit unions. Of this number, 122, or 26.0 percent of the total, were liquidated.<sup>2</sup>

Information concerning Michigan credit union liquidations is very scanty.<sup>3</sup> Table VIII gives some idea of liquidations over the past eight years.

Of the 122 liquidations, all but seven of them were purely voluntary and it must be assumed that the voluntarily liquidated credit unions paid to the shareholders at least 100 percent of the total shareholdings at the time of liquidation. When a credit union decides to liquidate voluntarily, after a vote of the membership of which four-fifths of the entire membership must vote to dissolve, the said credit union must file with the banking commissioner a statement to that effect. The commissioner determines whether or

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<sup>1</sup> Delmar C. Nagel, oral communication.

<sup>2</sup> Ibid.

<sup>3</sup> Many state records were destroyed by fire in 1951.

TABLE VIII

NUMBER OF STATE CHARTERS ISSUED AND CANCELED  
IN MICHIGAN, BY YEARS, AS OF  
DECEMBER 31, 1946-1951

Year	Number of Charters		Percentage of Total Credit Unions
	Granted	Canceled	
1946	4	10	6.8
1947	6	4	2.7
1948	9	1	0.6
1949	4	1	0.6
1950	6	2	1.2
1951	6	0	0.0
1952	8	2	1.1
1953	63	7	3.0
Total	106	27	

Source: Abstract of Reports of Credit Unions, State Banking Department, Lansing, 1946-1953.

not the credit union is solvent at the time that the statement is filed.<sup>1</sup>

The test of solvency is whether or not the credit union has sufficient assets to offset liabilities. If such is the case, the bank commissioner issues a certificate effecting the dissolution procedure. Now if something should happen whereby loans cannot be collected after the certificate is issued, there is no way for the commissioner to know of this. Thus it can only be assumed that the liquidated credit unions repayed 100 percent to the shareholders.

Only seven of the 122 credit unions liquidated since 1925 were placed in receivership.<sup>2</sup> This amounts to 5.7 percent of the unions liquidated and only 1.5 percent of the total credit unions chartered since 1925. Of the seven placed in receivership, five of them paid 100 percent of shareholdings to shareholders, one paid 95 percent, and one paid 70.56 percent. The total loss to shareholders of the two credit unions paying less than 100 percent of shareholdings amounted to only \$999.39.<sup>3</sup>

From the above figures it can be seen that although the rate of credit union liquidation has been high (one out of every four

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<sup>1</sup> Michigan Credit Union Act, op. cit., Section 20.

<sup>2</sup> Delmar C. Nagel, oral communication.

<sup>3</sup> Ibid.

chartered), the number of unions placed in receivership and the number of unions sustaining losses, and the losses sustained, were infinitesimally small.

The reasons for liquidation follow very closely those given for federal-chartered credit unions. The primary reasons for liquidations were:

1. Loss in interest on the part of members.
2. Closing or moving of plant in which members worked.
3. Lack of membership and capital with which to operate.
4. Change to a federal charter or to join a federally chartered credit union.

The first three reasons given indicate clearly that there is a definite need for increasing and/or redefining the requirements to be met before a credit union charter is granted.

Like the Federal Credit Union Act, the Michigan Credit Union Act provides that any seven residents may apply to the commissioner of the State Banking Department for permission to organize a credit union.<sup>1</sup> Final approval of the application rests with the banking commissioner, who must decide if it is wise to issue a charter.

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<sup>1</sup> Michigan Credit Union Act, op. cit., Section 1.

The law provides no guidepost for the commissioner to employ in passing judgment on the application. The application need only conform with the law and the applying organization should be of benefit to the members. Some definite provisions are needed to be used as guideposts in judgment of applications for charters. The State of Illinois recently revised its credit union act and recognized the need for these guideposts. The Illinois act provides that the Auditor of Public Accounts (bank commissioner) shall not issue a certificate of approval for the incorporation of a credit union unless it is shown that the field of membership in which the credit union proposes to operate provides a common bond of interest such as may reasonably be deemed to assure the success of the credit union. The existence of such a common bond and potential membership shall be considered adequate if one of the following conditions is met:<sup>1</sup>

1. In the case of an associational credit union, membership is limited to persons belonging to a specific local association or organization, including but not limited to churches, labor unions, clubs or societies, etc., and residing within a reasonable compact geographical neighborhood, and where membership of such Credit Unions exceeds 50 persons.<sup>2</sup>

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<sup>1</sup> Illinois Credit Union Act of 1953, Auditor of Public Accounts, State of Illinois, 1953.

<sup>2</sup> Loc. cit. (italics mine).



2. In the case of community credit unions, membership is limited to persons, their spouses and unmarried children who are residents of a reasonably compact and well defined neighborhood or community, the population of which does not exceed thirty thousand.<sup>1</sup>

3. In the case of occupational credit unions, membership is limited to persons having a common employer, and employed at one or more locations within a reasonably compact geographical area, and whose field of membership exceeds 50 persons.<sup>2</sup>

A rule-of-thumb method, for use in judging charter applications, that has some reliability in prediction, as viewed by past statistics, is given here for consideration. It has been established by experience that a credit union requires two members to support each borrower. For example, at the end of 1953 total membership in Michigan-chartered credit unions amounted to 164,627, while borrowers amounted to 82,448. The average shareholding amounted to \$395, while the average loan amounted to \$679 per borrower, or a 2-to-1 ratio of shareholdings to loans. With this rule in mind, if a group of 100 persons decide to apply for a credit union charter, each person pledging to buy one share of stock with a par value of ten dollars, \$1,000 of capital would be created. Now if the rule follows that one-third of these people will borrow at the average loan amount of \$395, the rest of the members must be able to place

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<sup>1</sup> Loc. cit. (italics mine).

<sup>2</sup> Loc. cit. (italics mine).

\$679 each into the credit union. Of course this method has many weaknesses but further study may prove it worth while.

It is readily admitted that the decision of what constitutes a sufficient common bond of interest to deem a potential credit union successful is a purely arbitrary matter. However, the provisions of the Illinois Credit Union Act, in attempting to arrive at some yardstick to be used in measuring the potential success of a credit union application, has established some guideposts to be consulted before issuing a charter, which would appear to enhance the success of the credit union more than does the provision that any seven residents may apply for a credit union charter.

The credit unions will, no doubt, be the first to applaud the aforementioned provisions of the Illinois Credit Union Act. The present Michigan Credit Union Act leaves a great deal of discretion in the hands of the Bank Commissioner as to whether or not the applicants for a charter receive a charter. The present Banking Commission has been very cooperative with the credit unions and has maintained a recommendable impartial supervisory attitude toward credit unions and applications for charters. However, Michigan state-chartered credit unions have had experience under an anti-credit union banking commission, when state charters were next to

impossible to obtain, and charter applicants turned to the Bureau of Federal Credit Unions for their charters.<sup>1</sup> Justice to the banking department and to the credit unions requires that some measure of minimum insurance of credit union success be established and employed in judging charter applications.

It must not be inferred from the above suggestion that all discretion over final approval of charter applications should be removed from the hands of the banking commissioner. The banking commissioner performs a valuable service to the public, to existing credit unions, and to applicants when he refuses charters to unqualified applicants or to applicants who have no justifiable purpose in establishing a credit union. The majority of applicants for credit union charters are honest, intelligent people who could benefit from the establishment of a credit union. Unfortunately there are some people, normally termed "go-getters" or "organizers," who desire the creation of a credit union only to enhance their personal power and prestige or to secure some special advantage.<sup>2</sup> The banking commissioner is a defender of unsuspecting persons, and is interested in protecting the future shareholders of the credit unions.

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<sup>1</sup> C. J. McLanahan, Director of Training, Michigan Credit Union League, oral communication.

<sup>2</sup> Delmar C. Nagel, oral communication.

The recommendation mentioned previously, whereby an employer must file a sixty-day advance notice of intent to move or close his plant, is equally applicable on the state level as on the federal level.

The discussion of credit union liquidations, both state- and federal-chartered, has served to point up weaknesses in the organization requirements of credit union charter applicants, under the Michigan Credit Union Act and the Federal Credit Union Act. These weaknesses must be removed before full confidence of the public will be placed in the credit unions.

## CHAPTER IV

### REGULATION OF SIMILAR INSTITUTIONS

Credit unions originated in Europe, when German farmers in 1850 organized cooperative banks whereby the farmers could borrow funds at low rates of interest to purchase needed tools and seed with which to farm.<sup>1</sup> Credit unions developed in the United States for somewhat the same purpose, to provide so-called remedial or emergency loans, at low rates of interest, for such things as doctor bills, burial expenses, and other unexpected large drains on the small wage earner's pocketbook. Funds were available from banks or loan companies but at exorbitant rates of interest. The credit unions filled the gap. Few people, if any, realized that the favorable legislation passed during the nineteen-twenties and thirties would create financial institutions which would someday have loans outstanding of over a billion dollars. As long as the credit unions confined themselves to small remedial loans, other financial institutions paid little

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<sup>1</sup> Lincoln H. Clark, The Credit-Union Legal Framework, The Journal of Business, University of Chicago, October, 1943, January, 1944, p. 236.

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heed to their petty progress. However, when in the last ten years credit unions began to provide funds for automobile, appliance, and real estate purchases, in direct competition with commercial banks and personal finance companies, the executives began to look more closely at the legislation that had slipped by unnoticed in the nineteen-twenties and thirties.

Since 1939 the amount of United States installment credit held by credit unions has increased more than ten times, a far more rapid rate of growth than was experienced by any other financial institution or retail outlet. In 1939 credit unions held \$132 million of installment credit. By 1953 it amounted to \$1,124 million. As of October, 1954, it amounted to \$1,270 million (see Table IX).

The loudest and the soundest complaint against the credit unions has been made on the grounds that credit unions have been subsidized and favored by legislation which favors credit unions but discriminates against other financial institutions. The credit unions through subsidies have been able to charge lower rates of interest on their loans in many cases, and because of reduced expenses, made possible by the subsidies, they are able to declare higher dividend earnings than can institutions which do not receive these subsidies.

TABLE IX

UNITED STATES INSTALLMENT CREDIT BY HOLDER  
(estimated, in millions of dollars)

Year	Com- mercial Banks	Sales Finance Com- panies	Credit Unions	Retail Outlets
1939	1,079	1,197	132	1,438
1940	1,452	1,575	171	1,596
1941	1,726	1,797	198	1,605
1942	862	588	128	990
1945	745	300	102	686
1946	1,567	677	151	937
1947	2,625	1,355	235	1,440
1948	3,529	1,990	334	1,876
1949	4,439	2,950	438	2,269
1950	5,798	3,785	590	2,670
1951	5,771	3,769	635	2,760
1952	7,524	4,833	837	3,274
1953	8,856	6,147	1,125	3,273
1954 Oct.	8,637	6,315	1,270	3,226

Source: Federal Reserve Bulletin, Board of Governors of the Federal Reserve System, Washington, December, 1954, p. 1294.



### Personal Service Subsidies

All operating, supervisory, accounting, and other services are donated by the members of the credit unions. Salaries are thereby eliminated, which are a high cost item to other commercial institutions.

### Corporate Subsidies

Almost all firms in which the employees have organized credit unions donate office space, heat, and light free of charge to the credit union. Further, some first provide a check-off system of share collection, whereby the payroll department deducts share payments from the paycheck of the individual, without charge to the union.

### Government Subsidies

Free services. Both the state banking departments and the Federal Bureau of Credit Unions furnish free forms of incorporation, reporting forms, and by-laws to the credit unions. State bank commissioners and their staffs devote much of their time to giving free advice and assistance to credit unions desiring aid. Further, in cases where credit unions have been placed in receivership, the State Banking Department charges no receivership costs to the credit

union.<sup>1</sup> Many times, if receivership costs were charged they would amount to more than the funds remaining to be distributed to the shareholders, after the sale of assets and payment of liabilities. This service enables credit unions to repay 100 percent of the shareholdings to the shareholders, who otherwise might suffer a loss.

Taxation. Section 22 of the Michigan Credit Union Act provides that a credit union shall be deemed an institution for savings and, together with all the accumulations therein, shall not be subject to taxation except as to real estate owned and that the shares of a credit union shall not be subject to a stock transfer tax when issued by the corporation or when transferred from one member to another. Section 18 of the Federal Credit Union Act provides that credit unions, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation except that any real property and any tangible personal property shall be subject to property taxes. The above two provisions place credit unions in a very advantageous position. Michigan-chartered banks and savings and loan or building and loan associations are subject to a yearly intangibles tax of 0.04 percent of the face value of

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<sup>1</sup> Delmar C. Nagel, oral communication.

the assets as it is equal to the amount of its total deposit liabilities, or in the case of building and loan or savings and loan associations the amount of its share liabilities.<sup>1</sup> Further, the income earned by the commercial banks and finance companies is subject to the corporate income tax, which can go as high as 52 percent of the net income earned.

Rates. While the state and federal government operate to keep the expenses of a credit union low on the one hand, they also make it possible for credit unions to charge a higher rate of interest on their loans to members. Credit unions are allowed to charge 1 percent per month on loans, many of which are based on such fundamental security as real estate insured by the Federal Housing Administration, or guaranteed by the Veterans' Administration, while banks are limited to 4 to 6 percent, even though their cost of operations are higher, and they do not enjoy exemption from legislation. In the case of small loans, excepting credit unions, every small loan licensee may lend any sum of money not to exceed \$500 in amount and may receive thereon charges at a rate not exceeding

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<sup>1</sup> Maurice C. Eveland and Fred M. Alger, Jr., Michigan Financial Institutions Act, Lansing, 1951, Section 205.133a, p. 209.

3 percent per month on the unpaid balance of any loan not in excess of \$50, and 2.5 percent per month of any loan in excess of \$50 but not in excess of \$300, and 0.75 percent per month on any remainder of such unpaid balance.<sup>1</sup>

Organization requirements. Mention has already been made of the ease with which credit unions may be organized. No minimum capital requirement is made for credit unions. In comparison, no bank can be organized in Michigan with any less capital than \$25,000.<sup>2</sup> The minimum capital requirement for a bank can be as high as \$500,000 if the place where its business is transacted happens to be in a city with a population which exceeds 300,000.<sup>3</sup> Applicants for a small loan license must have available for the operation of such a business liquid assets of at least \$5,000 in a city of more than 5,000 population, or \$10,000 in a city of more than 10,000 persons.<sup>4</sup>

The Michigan-chartered credit unions pay no fee for their charters, and aside from the annual \$25 examination fee, pay no

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<sup>1</sup> Ibid., Section 493.13, p. 399.

<sup>2</sup> Ibid., Section 487.40, p. 24.

<sup>3</sup> Loc. cit.

<sup>4</sup> Ibid., Michigan Financial Institutions Act, Section 493.2, p.

other fees to cover the cost of supervision. Federal-chartered credit unions pay a \$25 organizational fee and examination fees outlined on page 45. In comparison, small loan license applicants pay the banking commissioner the sum of \$50 as a fee for investigating the application and the additional sum of \$150 as an annual license fee and payment for examination expenses.<sup>1</sup>

Banks in Michigan likewise pay a \$50 application fee. Within 30 days after filing its articles of incorporation, the bank must notify the commission that all its capital and surplus has been paid in, whereupon the commission examines the condition of the bank to ascertain the amount of money paid in on account of its capital and surplus. All expenses incurred by the commission in making the examination are paid by the bank. For the annual examination, each bank must pay into the state treasury for the credit of the general fund not less than 0.0075 percent of the gross amount of assets, nor more than 0.025 percent of the gross amount of the assets. The fee is determined by the commissioner of banking. The minimum fee is \$75.<sup>2</sup>

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<sup>1</sup> Loc. cit.

<sup>2</sup> Michigan Financial Institutions Act, op. cit., Section 487.14,  
p. 12.

The comparisons made between a few provisions governing credit unions and other similar financial institutions has clearly indicated that the credit unions have been afforded special privileges in many areas. It may be well to stop and define the meaning used when referring to credit unions, small loan companies, and commercial banks as being similar institutions of finance. Many persons, even today, are voicing the opinion that credit unions perform operations entirely different from banks and small loan companies, and therefore require special legislation. When credit unions first developed, it is true, that they were special institutions, making a special type of loan and their primary purpose was to develop in their members the habit of thrift and systematic savings. As years passed and people began to carry life and hospitalization insurance, and pension plans came into effect, the operations of the credit unions were revolutionized, to the extent that making loans became their primary purpose. Loans not simply for "provident" and "productive" purposes, but in a majority of cases for the purchase of "luxury" items, for which the credit union member could not afford to pay cash, but would have to save for long periods of time, or borrow money from the normal suppliers of consumer credit. With the disappearance of the loan sharks, the adoption of small loan

laws which reduced the interest rate to a reasonable amount, and the increased supervision placed upon lending agencies, people today have little need to fear borrowing from the normal suppliers of consumer credit. Further, credit unions have been able to declare dividends of 4 to 6 percent per year on savings, which exceeds that offered by any other savings institution. This higher rate of interest has attracted people to form credit unions not for the purposes of promoting thrift, but only for the purpose of earning higher rates of interest on their savings.

When the credit unions begin making loans for "luxury goods" and are established merely to gain the higher earnings on savings, they lose their uniqueness and become a profit-making corporation, the same as a bank, sales finance company, or a small loan company.

If it is once admitted that credit unions are organized for the same purpose as a bank, sales finance company, or a small loan company, there is little valid reason for government subsidization. In fact, the paternalistic attitude of government raises a grave question. Subsidies indicate a weakness or an inability to cope, unaided, with competing organizations. It is inconsistent, therefore, to advocate participation in an unsound agency, as the most economical one to use, when the ability to charge lower rates on loans and to

declare larger dividends, is dependent, in part at least, on the exemption from obligations that the state imposes upon others.

It is not the aim of the author to favor the removal of credit unions, or the passage of prohibitive credit union legislation. The problem seems to boil down to a choice between one of two alternatives. First, if the credit unions confine their activities to the operations for which they were originally created, that of providing remedial loans and promoting thrift among their members, then there is little need for any serious revision of the credit union acts, to bring them in line with competing financial institutions. But, if credit unions continue to expand their operations into the field of luxury goods purchases, and real estate loans, the only righteous alternative left is to remove those sections of the credit union acts which enable them to enjoy unjust advantages over their competitors.

There seems to be little likelihood of credit unions accepting the first alternative; therefore, recommendations regarding the second alternative must be considered. The following recommendations, if adopted, would remove all the flagrant discrepancies existing between credit union, bank, and small loan legislation.

1. A uniform examination fee to be charged to all financial institutions, based on the amount of their assets.



2. Credit unions to be required to pay the full expenses of any and all banking commission assistance, and supervision, at the going rate.
3. A required minimum shareholding of \$50 before a credit union member will be granted a loan.
4. A required capitalization of an amount equal to \$100 per member before granting a credit union charter.
5. Equal taxation, both of gross assets as intangibles and earnings as corporate income, of all financial institutions.

The above recommendations may indeed seem harsh to a credit union member or representative, but they may serve to open the eyes of credit union leaders to the advantages they enjoy over their competitors, in the way of favorable legislation. Recognition must be given to the credit unions for the fine job they have done in the past and for the fine job they are doing today. Their expansion has been nothing short of phenomenal. Nevertheless, it must be recognized that this expansion has occurred, in part if not entirely, at the expense of others, who have not been placed in an equally enviable position.

## CHAPTER V

### UNIFORM CREDIT UNION CODE

Within the past few years there has developed strong agitation for the adoption of a uniform credit union code which would govern all credit unions. There are many arguments for and against such a proposal which must be considered before any such action is taken.

Each of the forty-four states granting credit union charters, and the Federal Bureau of Credit Unions chartering federal credit unions, have individual legislation governing the organization and operation of credit unions. In these forty-four states, credit unions can choose between state and federal regulation before incorporation and, later, if it is found advisable, dissolve, and the switch from one to the other. The choice depends on whichever of the two laws appears to be more liberal to the members. Niefield expresses the view that:

. . . this makes for competition between the federal statute and the state statutes. There is no real need or advantage in having two systems. After satisfactory experience under the Federal Law, the several states should abolish the local credit union laws.<sup>1</sup>

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<sup>1</sup> M. R. Niefeld, Cooperative Consumer Credit, with Special Reference to Credit Unions, New York, Harper & Bros., 1936, p. 174.

Banking department officials have complained of this "competition." They feel that it does little if any good for the state legislatures to put some "teeth" into a state credit union code when the credit unions can avoid the increased regulation by switching to a federal charter. This switching of charter involves the dissolution of the old credit union and an application for a new charter. The proceedings often cause members to lose some faith in the credit union dissolving. Age of operation is a very important factor considered by a depositor before he places his funds in a financial institution. There is nothing to prevent a credit union from switching back and forth from a state charter to a federal charter whenever it is felt by the credit union members that some advantage can be gained. There is little possibility of making either the state laws or the federal law truly effective as long as credit unions may change their form of charter at will.

Credit union regulation varies from state to state. Requirements regarding acceptance of deposits, maximum interest rate to be charged, value of shares, taxation, examination fees, and loan limits are different in almost every state. Progressive credit union states have of course amended their statutes to comply with the changed conditions which have occurred since the enactment of

their credit union law. Yet, many states govern credit unions with the original legislation which was enacted in 1924, 1925, 1929, et cetera. and have never been amended to this day. Certainly conditions regarding credit union operations have changed sufficiently to warrant a second look at the existing credit union legislation.

The variability of the individual credit union acts has been a prime reason for the unavailability of credit union statistics, on the state level. It is very difficult for anyone to consult the forty-four individual agencies in charge of credit unions, for information on credit union activities. The need of statistics is not a very wise basis of argument for a uniform credit union code, standing alone. But further reason and justification of this is given below.

A uniform credit union code has many advantages. In areas such as regulation by a single agency, devoted to credit union operations alone, uniform consistent requirements, effective management through standardized procedures of operation and reporting, and reporting to a central agency which can provide valuable statistics not only on a yearly basis as at present but on a monthly basis, adoption of a uniform code could prove very beneficial to credit unions and to all persons concerned.

In times of emergency, such as occurred in September, 1950, when, under the Board of Governors' Regulation W, each business

engaged in extending credit was required to submit certain credit data to the regional Federal Reserve Bank, a single credit union agency could greatly facilitate data collection and conformation to regulations regarding the furnishing of credit. It is at times such as this that statistics become very important.

A rather farsighted but overlooked argument for a uniform credit union code is that of facilitating monetary control. Present monetary controls hinge upon the ability of the Federal Reserve System to control the money supply of the economy through affecting reserves of commercial banks. One of the principal objectives of adopting the Federal Reserve System was to mobilize and concentrate the gold reserves of the country and to introduce greater elasticity into the money supply, so as to avoid the money stringencies, and even panics, which had plagued the country at intervals for many years.<sup>1</sup> If we accept the idea of credit unions continuing their rapid rate of growth and expansion over the coming years, and more and more funds flow into the accounts of the credit unions, to a point where their ability to lend approaches that of commercial banks, it

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<sup>1</sup> "Reserve Requirements of Commercial Banks," Bank Reserves--Some Major Factors Affecting Them, Federal Reserve Bank of New York, New York, March, 1951, p. 5.

must be admitted that the ability of the Federal Reserve to affect monetary policy has been significantly reduced. Credit unions if placed under a single controlling agency would be more pliable to monetary policy than they are under the present system of charter granting and regulation by the individual states.

Regardless of the advantages to be gained by a uniform code for credit unions, some thought must be given to the two main advantages accruing to credit unions from a dual system.

Disregarding the political difficulty of abolishing the state laws, which must be overcome before a uniform code could be established, there remains the difficulty of writing a law for credit unions that would serve the needs and satisfy all local groups all over the country. The omnipresent difficulty is to determine the best standard at a given moment which can apply over a period of time to many diversified groups of people. The present method whereby individual states write the laws regarding credit unions, lends itself to providing individual consideration in a smaller area than would a uniform code. Nevertheless, if the rule of the majority is followed, with this majority opinion voiced by chosen representatives, there is no reason why a law cannot be written which will reflect the opinion of the majority, as evidenced by the success of the Federal Credit Union Act.

Credit unions prize their ability to switch from a state to a federal charter, or from a federal to a state charter, as the only effective means they have of combating anti-credit union campaigns by competing institutions who may have powerful influence on the state and/or national level.

In weighing both the advantages and disadvantages of a uniform credit union code, the author believes that any obstacles standing in the way of designing an unbiased and equitable uniform code, can be overcome, and that the gains from improved supervision, regulation, management, reporting, and especially from improved emergency controls, make the adoption of a uniform code desirable.

## CHAPTER VI

### SUMMARY, CONCLUSIONS, AND SUGGESTIONS FOR FURTHER STUDY

#### Summary

The competitive world in which credit unions have to operate has changed since 1907. There was a time when few of the American people could get low-rate credit. With the increased volume of consumer credit, however, commercial banks, small loan agencies, personal finance companies, industrial banks, remedial loan agencies, and credit unions answered the need. The credit union has always possessed one operating advantage over commercial lenders. They have the ability to supply the very short-term loans, at low rates of interest. Wage earners wish to borrow with the privilege of repaying their loans in small installments--a little each payday. It costs the lender something to take in and acknowledge receipts of installment payments. Because most of these small loans entail added expense of one kind or another, it is not possible for commercial lenders to deal profitably in very small amounts of principal at low rates. But credit unions when properly cooperative are in a



position to avoid many of the costs of handling loans. Their loans, therefore, may in most instances be made for any price that will return enough to pay for the use of the money itself.

Possessing this advantage, over other lenders, and other advantages provided by credit union enabling acts of the individual states and the federal government, the credit unions forged ahead, gaining membership and funds at a very rapid rate until today they stand third in the list of installment lenders, topped only by banks and small loan companies.

Michigan has been an outstanding state in the development of credit unions. Since 1925, credit unions in Michigan have grown each year and at the end of 1953 Michigan stood third in the nation, in the number of credit unions, members, and assets.

In the past forty years credit unions have established for themselves a fine record of service, honesty, and durability. In Michigan the record of state-chartered credit unions is one of the best in the country. Seven forced liquidations in over twenty-five years of operation is a record unmatched by other similar types of institutions. But credit unions are not perfect. There have been substantial gains, but there has been dishonesty; there has been incompetence; and there has been misguided leadership. These

shortcomings have been experienced by every other institution, regardless of type. In the credit union there is no automatic system for capturing skill, insuring honesty or avoiding the sweep of economic forces.

This study has attempted to look at the credit unions objectively and with an open mind. The legislation governing credit unions was examined to see just how much protection of members' funds was provided by the credit union acts. Shortcomings of the acts were discussed in an attempt to see if the acts could be strengthened to provide greater protection of the depositors and shareholders. Popular theories were discussed and attempts were made to substantiate them or refute them as the facts warranted. In the next section of the study, the author will list suggested reforms which he believes will aid the development of credit unions and provide increased protection of credit union members' funds.

Before offering suggested reforms in the credit union acts, the author would like to express his beliefs on what the future holds for credit unions.

The author firmly believes that the future "can" be very bright and encouraging for credit union leaders and members. Whether or not "can be bright" can be changed to "is bright"

depends solely on the credit union officials and members. In order to ensure for themselves a bright future, credit union leaders must be willing to recognize and accept the following principles regarding credit union operations.

1. Credit unions are essentially small loan agencies. Credit unions in America are associations of consumers. The membership is made up of people of limited means. The credit needs that are best served in such groups are those for small loans. Small loans offer the credit union a field in which it can excel. These loans are too small to be made profitably by regulated commercial loan companies which have to carry operating expenses and pay taxes.

2. Credit unions are limited profit-making organizations. As they increase in size, credit unions tend to lose their cooperative and mutual qualities. Income from shares and deposits is offered as one of the attractions to memberships, and unless such income materializes, credit unions suffer from withdrawal of capital funds. In some instances too much stress has been put on the size of the dividend. Limited interest on capital is a fundamental principle of cooperation.

3. Thrift promotion is the primary function of credit unions. The purpose of credit unions is not to engage in efforts to displace

existing agencies but to provide services and guidance which these other agencies do not or cannot provide. Special enabling acts were passed to allow credit unions to help the small money borrowers who were subjected to the high rates of illegal money lenders. The original idea was for the credit union to help the debt-ridden individual pay off his debt at a low rate of interest, and then instill in him the idea of systematic saving to enable him to avoid falling into similar situations.

4. Size is not the most important factor. In recent years, credit unions have become engrossed with efforts to increase the size of their individual credit unions. Effort should be directed toward providing services honestly, quickly, and efficiently, to the existing membership. Size alone is no indication of success. Success for credit unions lies in the area of providing the services to their members, which other agencies cannot provide. One of the cardinal foundations of cooperative enterprises is the individual contacts and friendship which the members are able to cultivate. A feeling of "belonging" to a group should be felt by every credit union member. The credit union should stress that the aim of their economic activity is only to help in satisfying the membership needs.

If credit union leaders accept the above principles there is no reason why they cannot continue to provide these special services to

their members, and the author will then be able to say the future 'is' bright for the credit unions.

### Conclusions

Study of the Michigan Credit Union Act has led the author to the conclusion that the act is in need of revision to increase the protection provided for credit union members' funds, and to remove the no longer justifiable advantages which credit unions received over similar institutions when the Michigan Credit Union Act was adopted in 1925. The suggested reforms listed below are equally applicable to all credit union acts, as they are to the Michigan Credit Union Act. The suggested reforms have been discussed throughout the study, and are listed here for easier reference.

1. A maximum share limit should be provided by law. To prevent a credit union from becoming dependent upon a single or a few shareholders, due to the largeness of their shareholdings, a maximum limit should be established by law, expressed as a percentage of the total shares outstanding. This would provide a safeguard against the possibility of the board of directors setting too high a limit through ignorance or through desire to give special persons coercive powers.

2. At least 20 percent of real estate loans should be guaranteed loans. Real estate loans are dangerous for credit unions to hold. They involve large loans, and real estate values fluctuate widely. Therefore, if credit unions insist upon making real estate loans, at least 20 percent of these or more should be required to be insured loans of the VA or FHA type.

3. Diversification of credit union loans is needed. The method of solving the problem of diversifying credit union loans is a difficult one indeed, but one that must be successfully overcome. "Putting all your eggs into one basket" has never been a sound insurance or banking policy. The most reasonably acceptable answer to the problem seems to be one whereby a central agency of the credit unions is established to insure the purchase of outstanding loans of a credit union in difficulty. Credit unions on the whole are widely diversified among the various occupational groups, so that in a period of recession, enough of the members should be employed to be able to carry the credit unions that are hard hit by unemployment.

4. Credit unions should be subject to a reserve requirement similar to that imposed on savings banks. The 20 percent of net earnings reserve requirement is totally inadequate to provide any real protection of members' funds. Reserves only increase when

loans increase, since reserves are paid out of earnings. A more logical requirement would be for a reserve ratio of at least 12 percent of total assets, with government obligations to be considered as qualifying as reserves. This requirement would place more emphasis on the relation between paid-in capital and reserves. If a conservative minimum reserve ratio is enforced there will be no need for a maximum reserve requirement.

5. Funds should be provided for effective regulation. The services provided by the State Banking Department are for the protection of the funds which the members have entrusted to the credit union. If credit union members are willing to place their savings in the credit union, certainly they should be willing to pay for the full costs of the protection provided to them by the Banking Department. Further, the cost of credit union regulation should be borne only by the credit unions, and should not be diffused upon the general public. Examination, organizational, and supervision rates should be scaled to cover the full costs of these operations, and the funds thereby collected should be earmarked for the supervising authority.

6. Credit union officers should be tested for competency. Credit union officers are often elected to important positions, which require the handling of large sums of money, with little background

knowledge of such transactions. The credit union act should require all officials of a credit union to attend a training course for credit union officials, and to pass a state examination, the cost of this service to be paid by the credit unions. This requirement would enhance the soundness of the credit union's loans and investments, and provide increased protection of the members' funds.

7. A minimum amount of desirability should be established before a charter is granted. Many credit unions fail to survive for any length of time due to the lack of interest on the part of the members or due to a lack of members. Before a charter is issued, charter requirements should be fulfilled. These requirements should include: (a) a minimum membership of 100 persons; and (b) a minimum capital of \$100 per person before the charter is granted.

8. A separate credit union regulatory agency is needed. Credit unions have reached the point of maturity where a separate agency is needed, familiar with credit union problems and operations, which will be able to devote full time to effectively supervising credit unions.

9. A uniform credit union code is needed. The existence of a dual system of charter granting has led to a difficulty in effectively regulating credit unions. Ability to evade regulation by switching of



charters is undesirable and unnecessary. One equitable law regulating all credit unions would increase the efficiency of credit union operations and control.

The remaining conclusions are based on the belief that credit unions are overstepping the purpose for which they were created, and therefore a need exists to place them in the same position as are other financial institutions. It is out of the realm of this study to discuss the question of whether or not it is socially desirable or economically desirable for society to encourage the use of consumer credit and to encourage saving by the average worker. If society deems it desirable to have low-cost lending and high-interest-paying savings institutions, for use by the common laborer, then of course the following conclusions would be totally out of the question.

10. Special tax exemption should be removed. Credit unions should be taxed, both on gross assets as intangibles, and on earnings as corporate income, as are commercial banks and small loan companies.

11. Corporate and government subsidies should be removed. Office quarters obtained without charge from an employer or from the federal government in the case of federal employees' credit unions, free payroll deductions, and free supplies should be discouraged as

providing the credit unions with an unfair advantage over competing financial institutions.

Reforms such as these eleven above, written into every credit union bill, should safeguard the credit union movement and protect it from any inherent weaknesses. The need for consumer credit is immense. The resources of all legitimate agencies can find ample scope for service in this field of finance.

#### Suggestions for Further Study

Mention has been repeatedly made to the almost complete lack of credit union statistics. Of late, more and more effort on both the state and national level has been directed toward the gathering of more-complete data on credit union activities. As this information is made available, further research on credit unions is desirable. The majority of credit union material written in the past has been devoted either to unsubstantiated theories regarding credit unions or to only very local coverage of their activities.

A current study of the types of credit union loans is needed to see for what purposes credit union funds are being made available. Such a study could refute or enforce the claim that credit unions are financing purchases of luxury goods, rather than providing remedial loans for emergencies.

While accurate yearly reports are becoming increasingly available, monthly reports could be of much use if the figures obtained were related in some way to monthly business conditions. The majority of the credit unions have never been subjected to a severe test during an economic crisis. They are untried institutions. A monthly study of credit union statistics to discover how changes in business conditions affect the loans, reserves, deposits, and loan repayments of credit unions would have important predictive value.

More investigation is needed into the causes of credit union liquidation, both voluntary and involuntary. Recent causes are desirable, since credit unions have only become important, relatively, in recent years. The causes of liquidation, no doubt, are rapidly changing as the nature of credit union operation is rapidly changing.

The growing emphasis placed upon automation by business leaders today no doubt will be of extreme importance to the future of credit unions. If, as it is commonly believed, continued automation is adopted by leading manufacturers, requiring mobility of large amounts of labor from the consumption goods industries to the investments goods industries, will the credit unions be able to follow the flow of labor without encountering unsolvable problems of rapid liquidation or even moderately rapid liquidation? One case in point,

although not caused by automation alone, was the credit union at the Willow Run, Michigan, plant when Kaiser-Frazer moved to Cleveland. A snarl developed when suddenly laid-off workers wanted their savings but found that most of the assets were out on loans. The situation has not been cleared up today, two years after the layoff.

In retrospect, the credit union founders and leaders can look at the past with a feeling of satisfaction. Helping millions of people solve their financial problems, without becoming a penny richer, is indeed observing the golden rule to its fullest extent. But the meditation on the past cannot be extended too long. The crisis of today is calling. What attitude credit union leaders will assume today will determine the future of credit unions tomorrow.

APPENDIX A

MICHIGAN CREDIT UNION ACT

**STATE BANKING DEPARTMENT**  
**LANSING, MICHIGAN**  
**CREDIT UNIONS**

**An Act to Provide for the Organization, Operation and Supervision of  
Credit Unions**

(Act 285, P. A. 1925.)

*The People of the State of Michigan enact:*

**Section 1. Organization and Definition.** Any seven residents of this state may apply to the commissioner of the state banking department for permission to organize a credit union. A credit union is a cooperative society, incorporated for the two-fold purpose of promoting thrift among its members and creating a source of credit for them at legitimate rates of interest for provident purposes. A credit union is organized in the following manner:

(a) The applicants execute in duplicate a certificate of organization by the terms of which they agree to be bound. The certificate shall state:

(1) The name and location of the proposed credit union.

(2) The names and addresses of the subscribers to the certificate and the number of shares subscribed by each.

(3) The par value of the shares of the credit union which shall not exceed ten dollars each.

(b) They next prepare and adopt by-laws for the general governments of the credit union consistent with the provisions of this act, and execute the same in duplicate.

(c) The certificate and the by-laws are forwarded to the said commissioner of the state banking department.

(d) The said commissioner of the state banking department shall, within thirty days of the receipt of said certificate and by-laws, determine whether they conform with the provisions of this act, and whether or not the organization of the credit union in question would benefit the members of it and be consistent with the purposes of this act. The granting of a certificate of organization shall in each and every case be discretionary with the commissioner of the state banking department.

(e) Thereupon the said commissioner shall notify the applicants of his decision. If it is favorable he shall issue a certificate of approval, attached to the duplicate certificate of organization and return the same, together with the duplicate by-laws, to the applicants.

(f) The applicants shall thereupon file the said duplicate of the certificate of organization, with the certificate of approval attached thereto, with the clerk of the county within which the credit union is to do business.

(g) Thereupon the applicants shall become and be a credit union, incorporated in accordance with the provisions of this act.

In order to simplify the organization of credit unions the said commissioner of the state banking department shall, upon the passage of this act, cause to be prepared an approved form of certificate of organization and a form of by-laws, consistent with this act, which may be used by credit union incorporators for their guidance, and on written application of any seven residents of the state, shall supply them without charge with a blank certificate of organization and a copy of said form of suggested by-laws.

Am. 1929, Act 303.  
Am. 1941, Act 185.

**Sec. 2. Amendments.** Any and all amendments to the by-laws must be approved by the said commissioner of the state banking department before they become operative.

**Sec. 3. Restriction.** It shall be a misdemeanor for any person, association, co-partnership or corporation (except corporations organized in accordance with the provisions of this act) to use the words "credit union" in their name or title.

**Sec. 4. Powers.** A credit union shall have the following powers:

(a) To receive the savings of its members either as payment on shares or as deposits (including the right to conduct Christmas clubs, vacation clubs and other such thrift organizations within the membership.)

(b) To make loans to members for provident or productive purposes.

(c) To make loans to a cooperative society or other organization having membership in the credit union.

(d) To deposit in state and national banks and, to an extent which shall not exceed twenty-five per cent of its capital, invest in the paid-up shares of building and loan associations and of other credit unions.

(e) To invest in any investment legal for savings banks or for trust funds in the state.

(f) To borrow money as hereinafter indicated.

**Sec. 5. Membership.** Credit union membership shall consist of the incorporators and such other persons as may be elected to membership and subscribe to at least one share, pay the initial installment thereon and the entrance fee. Organizations (incorporated or otherwise) composed for the most part of the same general group as the credit union membership may be members. Credit union organization shall be limited to groups (of both large and small membership) having a common bond of occupation, or association or to groups within a well-defined neighborhood, community or rural district.

**Sec. 6. Reports, etc.** Credit unions shall be under the supervision of the commissioner of the state banking department. They shall report to him at least annually on or before the thirty-first day of December on blanks supplied by him for that purpose. Additional reports may be required. Credit unions shall be examined at least annually by the said commissioner except that, if a credit union has assets of less than twenty-five thousand dollars he may accept the audit of a practicing public accountant in place of such examination. For each annual examination the credit union so examined shall pay into the state treasury to the credit of the general fund, the sum of twenty-five dollars, but no credit union shall be compelled to pay for more than one examination in any one year. For failure to file reports when due, unless excused for cause, the credit union shall pay to the treasurer of the state five dollars for each day of its delinquency. If the said commissioner determines that the credit union is violating the provisions of this act, or is insolvent, the said commissioner may serve notice on the credit union of his intention to revoke the certificate of approval. If, for a period of fifteen days after said notice, said violation continues, the said commissioner may revoke said certificate and take possession of the business and property of said credit union and maintain possession until such time as he shall permit it to continue business or its affairs are finally liquidated. He may take similar action if said report remains in arrears for more than fifteen days.

**Sec. 7. Fiscal Year.—Meetings.** The fiscal year of all credit unions shall end December thirty-first. Special meetings may be held in the manner indicated in the by-laws. At all meetings a member shall have but a single vote whatever his share holdings. To amend the by-laws, the proposed amendment must be contained in the call for the meeting and it must be approved by three-fourths of the members then present (which number must constitute a quorum) and by the said commissioner of the state banking department. There shall be no voting by proxy, a member other than a natural person casting a single vote through a delegated agent.

**Sec. 8. Elections.** At the annual meeting (the organization meeting shall be the first annual meeting) the credit union shall elect a board of directors of not less than five members, a credit committee of not less than three members and a supervisory committee of three members, all to hold office for such terms respectively as the by-laws provide and until successors qualify. A record of the names and addresses of the members of the board and committees and the officers shall be filed with the commissioner of the state banking department, within ten days of their election.

**Sec. 9. Directors and Officers.** At their first meeting the directors shall elect from their own number a president, vice-president, treasurer and clerk, of whom the last two named may be the same individual. It shall be the duty of the

directors to have general management of the affairs of the credit union, particularly:

- (a) To act on applications for membership.
- (b) To determine the interest rates on loans and on deposits.
- (c) To fix the amount of the surety bond which shall be required of all officers and employees handling money.
- (d) To declare dividends, and to transmit to the members recommended amendments to the by-laws.
- (e) To fill vacancies in the board and in the credit committee until successors are chosen and qualify.
- (f) To determine the maximum individual share holdings and the maximum individual loans which can be made with and without security, subject to such limitations upon loans as may have been placed upon them by the by-laws previously adopted and approved by the commissioner of the state banking department.
- (g) To have charge of investments other than loans to members.

The duties of the officers shall be as determined in the by-laws, except that the treasurer shall be the general manager. No member of the board or of either committee shall, as such, be compensated.

Ann. 1929, Act 3-3.

**Sec. 10. Credit Committee.** The credit committee shall have the general supervision of all loans to members. Applications for loans shall be on a form, prepared by the credit committee, and all applications shall set forth the purpose for which the loan is desired, the security, if any, offered, and such other data as may be required. Within the meaning of this section an assignment of shares or deposits or the endorsement of a note may be deemed security. At least a majority of the members of the credit committee shall pass on all loans and approval must be unanimous. The credit committee shall meet as often as may be necessary after due notice to each member.

**Sec. 11. Supervisory Committee.** The supervisory committee shall—

(a) Make an examination of the affairs of the credit union at least quarterly, including an audit of its books and, in the event said committee feel such action to be necessary, it shall call the members together thereafter and submit to them its report.

(b) Make an annual audit and report and submit the same at the annual meeting of the members.

(c) By unanimous vote, if it deem such action to be necessary to the proper conduct of the credit union, suspend any officer, director or member of committee and call the members together to act on such suspension. The members at said meeting may sustain such suspension and remove such officer permanently or may reinstate said officer.

By a majority vote the supervisory committee may call a special meeting of the members to consider any matter submitted to it by said committee. The said committee shall fill vacancies in its own membership.

**Sec. 12. Capital.** The capital of a credit union shall consist of the payments that have been made to it by the several members thereof on shares. The credit union shall have a lien on the shares and deposits of a member for any sum due to the credit union from said member or for any loan endorsed by him. A credit union may charge an entrance fee as may be provided by the by-laws.

**Sec. 13. Minors.** Shares may be issued and deposits received in the name of a minor or in trust in such manner as the by-laws may provide. The name of the beneficiary must be disclosed to the credit union.

**Sec. 14. Rates.** Interest rates on loans made by a credit union shall not exceed one per cent a month on unpaid balances.

**Sec. 15. Power to Borrow.** A credit union may borrow from any source in total sum which shall not exceed fifty per cent of its assets.

**Sec. 16. Loans.** A credit union may loan to members. Loans must be for a provident or productive purpose and are made subject to the conditions contained in the by-laws. A borrower may repay his loan in whole or in part any day the office of the credit union is open for business. No director, officer or member of committee may borrow from the credit union in which he holds office beyond the amount of his holdings in it in shares and deposits, nor may he endorse for borrowers.



Sec. 17. **Reserves.** All entrance fees, fines (which may be provided by the by-laws for failure to make repayments on loans and payments on shares when due), and each year, before the declaration of a dividend, twenty per cent of the net earnings, shall be set aside as a reserve fund which shall be kept liquid and intact and not loaned out to members, and shall belong to the corporation to be used as a reserve against bad loans and not be distributed except in case of liquidation.

Sec. 18. **Dividends.** On recommendation of the directors, a credit union may, at the end of the fiscal year, declare a dividend from net earnings, which dividend shall be paid on all shares outstanding at the end of the fiscal year. Shares which become fully paid up during the year shall be entitled to a proportional part of said dividend calculated from the first day of the month following such payment in full.

Sec. 19. **Expulsion.—Withdrawal.** A member may be expelled by a two-thirds vote of the members present at a special meeting called to consider the matter but only after a hearing. Any member may withdraw from the credit union at any time but notice of withdrawal may be required. All amounts paid on shares or as deposits of an expelled or withdrawing member, with any dividends or interest accredited thereto, to the date thereof, shall, as funds become available and after deducting all amounts due from the member to the credit union, be paid to him. The credit union may require sixty days' notice of intention to withdraw shares and thirty days' notice of intention to withdraw deposits. Withdrawing or expelled members shall have no further rights in the credit union but are not, by such expulsion or withdrawal, released from any remaining liability to the credit union.

Sec. 20. **Dissolution.** The process of voluntary dissolution shall be as follows :

(a) At a meeting called for the purpose (notice of which purpose must be contained in the call) four-fifths of the entire membership of the credit union may vote to dissolve the credit union.

(b) Thereupon they file with the said commissioner of the state banking department a statement of their consent to dissolution, attested by a majority of the officers and including the names and addresses of the officers and directors.

(c) The commissioner of the state banking department determines whether or not the credit union is solvent. If such is the fact he issues in duplicate a certificate to the effect that this section has been complied with.

(d) The certificate is filed with the county clerk of the county in which the credit union is located, whereupon the credit union is dissolved and shall cease to carry on business except for the purpose of liquidation.

(e) The credit union shall continue in existence for the purpose of discharging its debts, collecting and distributing its assets and doing all other acts required in order to wind up its business, and may sue and be sued for the purpose of enforcing such debts and obligations until its affairs are fully adjusted and wound up, for three years.

Sec. 21. **Change in Place of Business.** A credit union may change its place of business on written notice to said commissioner of the state banking department.

Sec. 22. **Taxation.** A credit union shall be deemed an institution for savings and, together with all the accumulations therein, shall not be subject to taxation except as to real estate owned. The shares of a credit union shall not be subject to a stock transfer tax when issued by the corporation or when transferred from one member to another.



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APPENDIX B

FEDERAL CREDIT UNION ACT

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- C. J. McLanahan, Director of Training, Michigan Credit Union League, Detroit, Michigan.
- Delmar C. Nagel, Deputy Commissioner, State Banking Department of Michigan, Lansing, Michigan.
- Lou Segadelli, Public Relations Director, Michigan Credit Union League, Detroit, Michigan.
- Ralph L. Stickle, Executive Manager, Michigan Bankers Association, Lansing, Michigan.
- Luther A. Whipple, Treasurer, Michigan State College Employees' Credit Union, East Lansing, Michigan.

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