**Testimony to Citizen Committee for Performance Measurement of Tax Preferences**

**Rob Stephens, Numerica Credit Union**

Thank you for the opportunity to talk with you about the implications of assessing business & occupation taxes on state-chartered credit unions. First, I would like to give a little background about my professional experience and about the credit union where I currently serve. I have worked for both banks and credit unions. I have been the CFO of two small community banks and have been the Director of Operations of a bank that was $4B at the time of my employment there. I currently serve as the SVP of Finance at Numerica Credit Union, which has over 137,000 members and almost 500 employees, the vast majority of which live and work in Washington State. Numerica has loaned over $1.6B to these members and has total assets of $2B. Numerica is designated as a low income credit union. 59% of our members make 80% or less of median family income.

Two significant considerations of whether to assess state-chartered credit unions for B&O taxes include (1) the mission and cooperative structure of credit unions and (2) the choice of federal versus state charters. Let's first consider the mission of credit unions. From the start, credit unions are cooperatives where members with funds to invest provide funds to members who need to borrow for needs like a house or a car. We can also allocate a small share of our loans to businesses. Some may look at the products we provide, our size, or the services we offer and conclude little difference in our purpose from a bank. I can assure you there is a major difference.

The capital to start or purchase a bank is daunting. Even if the capital is raised, it takes a large amount of assets until the entity can achieve the size needed to be profitable. The technology costs to compete against competitors of much larger scale and the required compliance infrastructure costs are large. The economic reality of this has prevented the start of new banks while small banks and credit unions continue to merge away. Thus, a bank takes a large of amount of investors to aggregate the capital needed for just a break-even scale and these investors must be compensated for the risk they assume. These investors often have no meaningful relationship with the bank as a customer.

I've been through multiple budget seasons at banks, been at annual shareholder meetings, and have written profitability systems and analysis. While I had a duty to the employees and customers, I was also very cognizant of my fiduciary duty to the shareholders. The investments we made had to earn enough to cover the cost of capital to provide a sufficient return to shareholders. Those who have the income or assets to provide these yields are the desired customer. When for-profit banks focus on these customers, who is there to serve these of lower income? Numerica's low income designation is testimony that credit unions are there to serve these people.

Many of the economic realities of banks are faced by credit unions. More and more, we have to strive for a size that allows us to operate profitably. Ultimately, though, we are a cooperative than can make decisions for the good of the membership of the whole, which means we can provide products and services that banks would not offer. Credit unions can provide public goods like financial education and community support that's driven by the cooperative mission. As an example, Numerica's core purpose is our commitment to enhancing lives, fulfilling dreams, and building communities to promote member well-being. This focus is certainly based on our cooperative structure but mirrors the mission of many not-for-profit entities.

Credit Unions can provide better rates than banks because we don't have to allocate a share of our earnings to outside investors and taxing authorities. We do not have the same pressures to amass risk to reach for yield or to distribute capital. The economics of this causes credit unions to generally operate with less risk than banks. Managers who imprudently reach for high current income to satisfy shareholder demands can take on too much risk, which eventually leads to losses. Banks also have pressure to distribute capital to shareholders to provide liquidity to them and to increase returns on equity. Capital takes the first losses so as it depletes it increases risk to depositors and creates more risk for the federal agencies that insure deposits. The Great Recession was a brutal lesson in this. For-profit financial institutions have failed at a rate of 3 to 1 compared to credit unions since 2008.

In summary, a credit union is a cooperative whose primary responsibility is to its member-owners. A bank's origination and continued existence is by the consent of investor shareholders. If the earnings from customers or operational efficiencies are not acceptable, then those bank investors will sell their shares, potentially to another bank.

Now, let's move to the choice of a state versus a federal charter for a credit union. Credit unions have the choice between being chartered with the state through the Department of Financial Institutions or being chartered with the federal NCUA. Many credit unions have chosen a state charter because we can work with local regulators and local legislators. Numerica has worked closely with the DFI on many issues.

At the same time, we continue to exercise powers of federal credit unions via Washington State's parity provision. The B&O tax exemption is another example of this parity. Federal credit unions do not pay B&O taxes and neither should state credit unions.

Despite these benefits, state-chartered credit unions pay sales and use tax while federally chartered credit unions do not. Surely this commission understands that forcing state-charted credit unions to pay B&O taxes creates an economic incentive for credit unions to switch to federal charters and pay neither B&O nor sales taxes. Numerica, and I assume all other state-chartered credit unions, would prefer to continue to work together with the Washington DFI as our primary regulator.

Finally, the B&O exemption has been discussion before. I would request you recommend to JLARC that the report accurately reflect that our legislature has reviewed the tax exemption. In 2009, the Washington State Financial Institutions and Insurance Committee correctly inferred that the state-chartered credit unions are exempt from the B&O tax for two reasons:

1) To recognize Washington State's not-for-profit nature and cooperative structure (which I discussed earlier) and
2) To create parity between federally-chartered and state-chartered credit unions.

These reasons have not changed and neither should the conclusion. I strongly urge you to support a "continue" recommendation for the credit union B&O tax exemption in the JLARC report.