



STATEMENT OF

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BEFORE THE
HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HEARING ON AN EXAMINATION OF THE CHALLENGES FACING COMMUNITY
FINANCIAL INSTITUTIONS IN TEXAS
EXAMINATION FAIRNESS AND REFORM ACT

WEDNESDAY, MARCH 14, 2012

I. Introduction

Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee, Air Force Federal Credit Union (Air Force FCU) appreciates the invitation to offer our views on the challenges facing community financial institutions in Texas.

In the invitation to testify, the Subcommittee has asked Air Force FCU to comment on the challenges facing community financial institutions in a number of different areas. Particular emphasis is to be given the challenges faced by community financial institutions in dealing with the increased volume and compliance costs of federal financial regulations; an overview of the role of community financial institutions play in Texas; the effect inconsistencies in the application of examination standards and guidance has on community financial institutions; and our thoughts on the future landscape for community financial institutions including the costs and benefits of consolidation in the industry.

This written testimony will provide background information about Air Force FCU, credit unions within Texas, explore some specific challenges that Air Force FCU faced in the implementation of some recent regulatory changes, provide comments about our examinations and our view of how industry consolidation will impact consumers.

II. About Air Force FCU

Air Force FCU was originally chartered November 3, 1952 to serve employees and military personnel, and employees of the Post Exchange of the Lackland Air Force Base who work in San Antonio, Texas; employees of the credit union; members of their immediate families; and organizations of such persons. Subsequent to that date, other groups were added to the Field of Membership, but in May 2010 we were approved for a single sponsor group that defined our Field of Membership (abbreviated) as all active duty military personnel (all branches of service), reservists, National Guard and Air Guard, Department of Defense civilian employees, Department of Defense contractor

employees working at or assigned to military installations within the states of Texas, Oklahoma, Arkansas, Mississippi, or Louisiana; military retirees and Department of Defense civilian retirees residing in the states of Texas, Oklahoma, Arkansas, Mississippi, or Louisiana; employees of the credit union; immediate family members of the foregoing groups; and organizations of such persons.

We provide consumer loans (including credit cards), mortgage loans, consumer deposit products and services and member business loans, member deposit products and services.

Our core values are the same core values as the military members we serve – Integrity First; Service Before Self; and Excellence in All We Do. We believe this alignment of core values uniquely positions us to perform our mission to: “Be the one financial Institution that best understands and meet the needs of our members, wherever they are.” Simply put, we are all about serving our members – adding value to their financial lives.

When originally chartered we had ten founding members each of whom made a \$5.00 initial share deposit. Today we have more than 36,900 members who own shares and equity valued at \$331.8 million. At year-end 2011 our total assets were \$342,423,115. Currently we have 142 employees – 131 full-time employees and 11 part-time employees.

III. Texas Credit Unions

The following data comes from the 5300 Reports that the National Credit Union Administration (NCUA) collected on credit unions in Texas as of December 31, 2011.

There were 536 credit unions which were headquartered in Texas. The largest of which held \$6,544,458,049 in total assets and the smallest of which held \$18,513 in total

assets. The average total assets of Texas credit unions were \$135,740,851. There were only 13 credit unions in Texas whose total assets exceeded \$1 billion.

There were 427 Texas credit unions with less than \$100 million in total assets. The average assets of these very small credit unions is approximately \$21.8 million and these institutions have on average 8 full-time employees and 1 part-time employee.

As will be noted later in this testimony, we have struggled at times to meet the compliance burden brought on by new regulations and by regulatory changes. It is hard to imagine facing these challenges with such limited resources. Truly the task must be daunting.

IV. Our Challenges and Concerns related to Recent Regulatory Changes

Our credit union has a proud history of compliance with regulations. We have always sought to be prompt and thorough. We are frustrated if we overlook even the smallest of details.

Our senior management team is comprised of ten individuals including myself. We have a Vice President for Compliance, who along with Vice Presidents who own certain products. They will coordinate modification of processes, staff training, coordinating changes to information systems, and coordinating third-party vendor responses. Often changes more complex than believed.

The burden of compliance is different with each regulation or regulatory change.

The Credit CARD Act of 2009

The Act had many provisions that were beneficial to consumers. In fact, there were many provisions that represented no challenge to our credit union at all because we were already doing business in ways that were aligned with the provisions. But as with

most any legislation, there were provisions that created challenges for us and with some considerable expense. Most of the expenses were centered in a few areas. In some instances one could argue that these expense-laden areas provided limited benefit to consumers or were not used by consumers to their greatest advantage.

Let us consider a few specific provisions that were challenging to Air Force FCU.

Due Dates of Payments on the Same Day of the Month

Before the Act, card issuers sent a monthly statement. The date the statements were prepared was based on a cycle billing system that allowed the issuer to spread their statement production over an entire calendar month so they could contain costs. Statements were usually prepared within a few days of the same date each month and the payment due date was in relation to when the statement would be prepared (usually 25 days after the statement was prepared).

Statement preparers scheduled their work so that they controlled overtime and would avoid certain days of the week as production days. For example, if statements were to be mailed, why would you prepare a statement on Saturday? There was no mail service on Sunday and it would result in the statement laying in a Post Office rather than moving toward the person owing the credit card obligation.

The Act required the issuer to select a day of the month that payments would be due and to prepare and mail a statement no less than 21 calendar days before the payment was due. When we were discussing the options with our vendor, we discovered that the only way to insure that we met the mailing deadline was for the vendor to move to a seven day per week processing schedule. While it did not have an immediate impact on the cost of our statement production because of contracts that were in place, we are quite confident that when we renegotiate the contract's renewal there will be additional costs to us to allow the vendor to recover the expense they were required to carry in the past as well as to cover the added cost going forward.

Required Changes to the Form and Content of Statements

There was substantial programming required to layout the new statement format to comply with the regulation. Because many credit unions use outside vendors to produce their credit card statements, our sector of the financial services industry was largely dependent on third party vendors for compliance. Certain information had to be on the first page of the statement. Additional information about the how long the account would take to be paid in full was added to the first page. In some instances, this required the statement to be longer than formerly required which drove up statement production expenses. Again, all the cost of the implementation has not immediately shown itself in our expenses because of the contracts that were in place at the time.

This particular provision is one that was well intended but from our perspective may not be having the desired outcome. We have no industry wide data to support our assumption but we do have our data. It appears that cardholders either are not paying attention to the information provided or due to other factors are acting in ways much different than anticipated.

We track the payment behavior of our credit card accounts. Monthly we obtain a report which shows what percentage of the credit card portfolio paid varying amounts compared to their balance or minimum required payment. We use four payment categories: those paying the account in full, paying the minimum payment, paying an amount greater than the minimum payment, and paying amounts less than the minimum required payment.

Included below are two charts that cover the same months but three years apart. The first chart shows the payment behavior before the Act took effect, the second chart shows the same information after the Act was in effect. We use the same months in each case to remove the seasonal differences that might slant the information. For

each month we show the percentage of our card accounts that paid in each of the four categories.

The table below comes from November 2008 through February 2009 (before the impact of the Act).

	Paid In Full	Paid Minimum Payment	Paid Less Than the Minimum	Paid More Than the Minimum
November 2008	12.2%	6.9%	16.4%	64.6%
December 2008	11.5%	7.6%	17.5%	63.4%
January 2009	9.8%	11.2%	15.5%	63.5%
February 2009	11.3%	8.1%	14.3%	66.3%

The table below is data from the same report for the last four months (November 2011 through February 2012)

	Paid In Full	Paid Minimum Payment	Paid Less Than the Minimum	Paid More Than the Minimum
November 2011	10.6%	11.5%	9.3%	68.6%
December 2011	10.2%	11.5%	9.1%	69.3%
January 2012	10.2%	11.7%	10.0%	68.1%
February 2012	11.3%	10.1%	8.8%	69.8%

In comparing the two charts we see fewer account holders paying their accounts in full, substantially more account holders are paying only the minimum payment, fewer are paying less than the required minimum payment and there is an increase in those paying more than the minimum required payment.

Required Notices for Interest Rate Changes

Prior to the Act's implementation, we as well as many others had a feature to our credit card products called "Penalty Pricing." If an account went 60 days past due, the interest rate on their account would escalate to 18% or the Maximum Legal Rate that Federal Credit Unions could charge, whichever was less. This pricing mechanism was intended to prompt members who found themselves in a position to make choices about which account they would pay, to pay their Air Force FCU credit card first and avoid the higher interest rate. Our penalty pricing provision allowed the cardholders rate to return to normal after six consecutive months of prompt payment.

The Act required that we send notices 45 days in advance of a rate change before the rate change would become effective. This meant that when the account was 15 days past due, we were required to send a notice to our members telling them that if their account went without sufficient payment to bring the account current within the next 45 days, we would increase their interest rate.

Our processing vendor was unable to adjust their program timely. In fact, this aspect of compliance has been an extended problem. Until just a few months ago, we were required to manually create our notices to comply with the regulation. We were also required to manually monitor the timely payment to remove the cardholder from the penalty pricing scenario.

Time to Respond

The Act was to generally become effective nine months after enactment, but there were exceptions to that time period within the Act's provision. One such exception dealt with the effective date of the advance notice provision on changes to interest rates and other types of changes. That time period was 90 days. The Act was signed into Law on May 22, 2009.

The Federal Reserve promulgated Regulation Z, which put into place the rules covered in the Truth in Lending Act. The Credit CARD Act of 2009 amended the Truth in Lending Act and as a result the Federal Reserve was required to amend Regulation Z. On July 15, 2009, the Federal Reserve Board approved an interim rule implementing the changes required by the Credit CARD Act. The first compliance trigger date was August 20, 2009. This provided financial institutions only a period of 5 weeks to understand and implement the rule the Federal Reserve had issued.

While we understand the need for deliberate speed in making certain provisions applicable, the short time period created stresses on the rule making and compliance process, and ultimately will likely prove to have been a more costly process.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

There are many good provisions of Dodd-Frank which strengthen the Financial Services Industry and will properly constrain those institutions who brought our economy to the brink of financial ruin, but there are some provisions that do nothing to strengthen the industry and are counter to Consumer Protection.

The Durbin Amendment

One provision which we would like to highlight is the so-called “Durbin Amendment” (Durbin). As you are aware, this provision deals with interchange rates charged merchants for certain electronic payments. Some of Durbin are not applicable to credit unions the size of Air Force FCU, but the cost of Durbin will be felt by our members ultimately.

Under Durbin we are required to have multiple networks over which transactions may clear. Retailers will have the opportunity to select the network that is most cost effective for them. The fact that that transaction volume will be split over multiple networks will cause any volume discounts accruing to financial institutions to be diluted.

Merchants also have the right to steer transaction payments to products they prefer. Durbin does not require Merchants to select the payment method most beneficial to the consumer. There seems to be what we would call a “mistaken” idea that the merchants’ preferences are aligned with the best interest of the consumer.

The interchange rule did not require networks to provide separate pricing for exempt and non-exempt institutions. Currently, the networks are adopting dual pricing, but many in our industry feel it is a matter of time before dual pricing goes away.

One concern that we have is that merchants will steer transactions away from the debit cards issued by smaller institutions. We believe we are already seeing this to a limited degree. Again our analysis is not made based on national statistics, but on statistics we keep on our operation. The first impact of Durbin was in July 2011. We compared monthly data from January 2006 through January 2012. We saw a consistently positive trend when we compared the same months from year to year, looking at debit card transactions, whether by number or by dollar volume. We had increases with an exception in only May 2009, until you get to July 2011. Since July 2011, we have only once had an increase in numbers of transactions compared to the same month the previous year, that being July 2011. We have had increases in dollar volumes of transactions using the same comparison only once in since July 2011 and that was in November 2011.

We have changed nothing in the way we handle debit card transactions since the beginning of 2010. How can we explain the sudden and clear change in the direction of activity? Is it only a coincidence that the change in direction happens when the Durbin Amendment takes effect? We have been looking for the cause. We would like to overcome the change in direction as interchange income from these transactions is a considerable contributor to our non-interest income. Presently, our assessment is that merchant steering may be a contributor.

An analysis of our checking accounts and debit cards shows: 94% of our checking accounts are free to our members. If we were to lose all of our interchange income we would need to impose fees on checking accounts of between \$7.00 and \$7.50 per month to maintain our current income levels.

Certainly, this is not something we would seriously entertain doing, but it does seem to support the level of fees being imposed by some large institutions that are being more severely impacted by the change in the interchange rule encapsulated in Durbin. While we realize it is too early to determine the full impact of Durbin we do believe it prudent to revisit the topic at some future time to determine the true benefit to consumers. The argument was that consumer prices would fall as a result of the adoption of Durbin.

We all need to be truthful about costs. The old saying that "There's no free lunch," is true. There are costs embedded in any payment system. Each party to the transaction realizes benefits from the payment arrangement, including the profit motive. Someone must pay for the infrastructure required to maintain the system. Ultimately, it will be the consumer who pays for the convenience.

The Consumer Financial Protection Bureau

In principle, we agree that consumers may be taken advantage of by some in the financial services industry. We also agree that consumers deserve protection from those unscrupulous individuals and entities. We do question, however, the need to create another bureaucracy that in most ways duplicates the effective efforts that were already in place in many instances.

From time to time, any business, no matter how well run will have an occasion where the business fails to meet the expectations of a consumer. Air Force FCU is no different in that regard. We pride ourselves in our service levels, but there are times where we are unable to meet the expectations of a member as we are forced to weigh the benefit of one member against the benefit of the whole membership.

In the almost six years that I have been with Air Force FCU, we may have had five or six instances where members felt compelled to write our regulator in regard to a particular position they held. Prior to the changes created by Dodd-Frank in this regard, such inquiries were directed to the Regional Offices of NCUA. There would be a letter of inquiry sent to the Supervisory Committee of the credit union. The Supervisory Committee would investigate the matter and respond to NCUA's Regional Office. The Regional Office would make a determination and would copy their response to the inquiring member to the Supervisory Committee so they would know of the determination. This usually would happen within a matter of a few days.

Once since the passage of Dodd-Frank we have had this type of inquiry. The letter of inquiry came from the NCUA Consumer Assistance Center in Alexandria, VA. We were provided a copy of our member's communication as had been the former practice. The research was performed by the Supervisory Committee and a response prepared and sent back to the NCUA Consumer Assistance Center. To date we have not heard further on the inquiry. We do not know of the position of NCUA with certainty, though we feel our action to have been proper, nor do we know if the member received any communication. Since this is a new process, we do not know if this is the Standard Operating Procedure or if there was a piece that fell through the crack so to speak.

We do know this. We had a process that seemed to work just fine. Now we have a different process with far more overhead. When we think of overhead, we think of expense. We believe that to be true in this case as well. We believe the CFPB can be a good effort, but like all agencies, there will be competition for more funding dollars.

V. Our Regulator – Fairness in Examinations

We believe NCUA to be a fair regulator when it comes to examinations. We do not always agree, but we do always work together to find acceptable solutions. We do not know if that can be said of all regulators, but we are confident in that statement about NCUA.

The NCUA, like Air Force FCU, has to be challenged by the activity of recent years. The economy is not performing as we would all like and as a result credit unions have challenges. Some of the challenges the credit unions faced were of their own doing. They entered new areas of business with limited experience and with little consideration of controlling the growth of the new business line. NCUA did warn against such practices. It does not take long for new business to overrun a small institution. It can take less time than the time between examinations. As a result, NCUA has increased the information obtained in the quarterly 5300 reports. We believe our regulator is on top of their game most of the time.

When regulators, including NCUA, are taken to task because there are failures during their watch, their natural tendency is to “tighten the reins.” Some credit unions may view this as unfair; we tend to believe it is a response to criticism.

If you consider that over the past few years we have had economic challenges to overcome and a larger than normal quantity of new regulations that the regulator and the regulated have had to learn, you have to believe NCUA has been well-managed.

We also need to recognize that NCUA has a dual role, regulator and insurer. They are a relatively small agency but they have oversight to some degree of a similar number of institutions as do the banking regulators. The range of complexity in the credit unions is considerable. NCUA has adopted area specialists for more complex institution examinations. NCUA has adopted a risk-based examination process, which requires more resources in credit unions with greater levels of risk. You almost have to give them an “Exceeds Expectations” grade on their processes.

VI. Industry Consolidation

Industry consolidation appears to be something that will happen whether we want it to happen or not. We believe that there is a place for small institutions who serve niche markets. Unfortunately, the burden of regulations, the demands of consumers for

certain products that have high costs of entry and maintenance, and the cost of employees will likely make these small institutions more difficult to maintain.


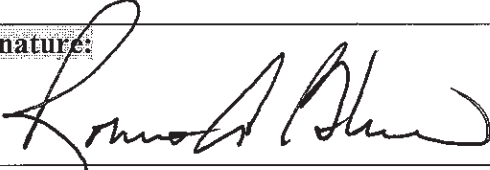
Credit unions, like most other businesses, need to reach a certain size to gain efficiencies. Some will grow no matter what it takes. There will be some within the credit union community who feel compelled to convert to other charters to gain a business advantage. The business differences between credit unions and banks are the mutual structure, the limitation on whom credit unions may serve, and that the share insurance fund's funding mechanism and management. NCUA and our trade associations oppose such a move. Our belief is that NCUA opposes conversions because it upsets the stability of the share insurance fund. It is true that most losses happen to smaller credit unions and the larger credit unions in some ways are subsidizing the smaller credit unions with the level funding method. Our opinion is that those credit unions who decide to move charters have been credit unions in name only and likely for some time.

Credit unions are all about people helping people. As long as there are dedicated individuals dedicated to that purpose above all else, credit unions will continue to exist and thrive.

United States House of Representatives
Committee on Financial Services

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Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Robert A. Glenn	Air Force Federal Credit Union
3. Business Address and telephone number: 	
4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
6. If you answered yes to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.	
7. Signature: 	

Please attach a copy of this form to your written testimony.