Testimony of

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On behalf of

The National Association of Federal Credit Unions

"Credit Card Lending and Small Business Perspectives"

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Introduction

Good morning Chairwoman Velazquez, Ranking Member Chabot and Members of the Committee. My name is William (Bill) Spearman and I am here today to testify on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as President and CEO of Mid-Hudson Valley Federal Credit Union (MHVFCU), headquartered in Kingston, New York. MHVFCU was founded to serve IBM employees in Kingston, but converted to a multi-occupational charter when the IBM plant closed in 1995, and to a community charter in 2002. Today, MHVFCU has nearly 50,000 members and $590 million in assets.

I have worked at MHVFCU for 36 years, serving as President and CEO for the last 14 of them. I currently serve on NAFCU's Education Committee and as a board member for the New York State Credit Union League (NYSCUL). I have also served on NAFCU's Regulatory and Advisory Committees, and was named one of the NYCUL's Professionals of the Year in 2004.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 federal credit unions—member owned financial institutions across the nation—representing more than 27 million individual credit union members. NAFCU–member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this hearing regarding credit cards and small business lending.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created and has been recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions continue to fill today for over 90 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's 8,305 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member, one vote”—regardless of the dollar amount they have on account. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without pay—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Credit unions have an unparalleled safety and soundness record. Unlike banks and thrifts, credit unions have never cost the American taxpayer a single dime. While the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) were both started with seed money from the United States Treasury, every dollar that has ever gone into the National Credit Union Share Insurance Fund (NCUSIF) has come from the credit unions it insures. Furthermore, unlike the thrift insurance fund that unfortunately cost hundreds of billions of dollars, credit unions have never needed a federal bailout.

Credit Unions and Small Business Lending

Small businesses often face more requirements to get a loan than an equally credit worthy, larger business because lenders view small businesses as riskier ventures. This is due in large part to the high failure rates of small businesses and the fact that proper valuation and credit worthiness of these businesses is hard to determine. As a result, financial institutions that have had ongoing relationships with small business members are in the best position to lend to them because of their experience working with a particular small business in the past. The unique not-for-profit, cooperative member-owner structure of credit unions enhances the relationship credit unions have with small businesses. Their structure means that credit unions design services to meet the needs of their membership – who can be small business owners and even the businesses themselves. It also means that the lender-borrower relationship is often very strong at credit unions.

This relationship allows credit unions to have a unique working knowledge of the owners, the way the business is run and other information about the borrower that other lenders do not have access to. Moreover, this relationship can lead to better lending decisions and mitigate the risk for both the credit union and the small business. Credit unions maintain a multitude of these unique relationships with current and potential small business owners throughout America.

As the Committee is well aware, small businesses today employ over half of all private sector employees. Small businesses also pay more than 45 percent of total U.S. private payroll and have generated 60 to 80 percent of net new jobs annually over the last decade. In short, small businesses are not only crucial to the health of the economy but also to the financial security of American families. Small business lending helps drive the development and expansion of small businesses in America. Many small business owners are members of credit unions around the country and rely on the services provided by them to help make their small business a success.

I am also pleased to report to the Committee that credit union participation in SBA programs is at an all time high. As of 2007 credit unions have made 3,398 SBA loans totaling close to $289 million. This is up from 297 loans totaling just over $20 million in 2004. Proportionately, the growth is substantial and credit unions can and would like to do more for America's small businesses when it comes to small business lending. At Mid Hudson Valley FCU we are an approved SBA lender. However, some of the cumbersome aspects of the SBA process and the restrictive nature of credit union member business lending limits constrain our efforts to take a more active role in the SBA 7(a) and 504 lending programs.

Even though credit unions have been able to grow in their ability to help small businesses, many want to do more. Unfortunately, many federal credit unions face an impediment to helping their small business members due to the arbitrary member business lending (MBL) cap that was placed on them in 1998 as part of the *Credit Union Membership Access Act*. This arbitrary cap is set at the lesser of 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets. Legislation has been introduced in the House that would attempt to provide relief to credit unions from the arbitrary cap. A provision of the *Credit Union Regulatory Improvements Act*, H.R. 1537, would raise this limit to 20% of total assets and adjust the current de-minimus level of loans exempt from the cap (current set at $50,000) to $100,000. NAFCU supports this modification of the current arbitrary cap on member business loans at a credit union from the current formula to a flat rate of 20 percent of the total assets of a credit union. This provision will facilitate member business lending without jeopardizing the safety and soundness of participating credit unions.

While the current cap was first arbitrarily imposed on credit unions in 1998, CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study entitled “Credit Union Member Business Lending” in which it concluded that “credit unions’ business lending currently has no effect on the viability and profitability of other insured depository institutions.” That same study also found that over 50 percent of credit union loans were made to businesses with assets under $100,000, and 45 percent of credit union business loans go to individuals with household incomes of less than $50,000. Furthermore, a 20 percent cap for credit union member business lending would be less than or equal to the business lending caps for other institutions. NAFCU also supports revising the current definition of a member business loan by giving the NCUA authority to exclude small loans of $100,000 or less as de minimus, rather than preserving the current threshold of $50,000. This would adjust the threshold for inflation, from the $50,000 level set in 1998. These much needed updates to the limits on credit union member business loans would promote economic growth by providing additional sources of credit for small businesses.

The *Credit Union Small Business Lending Act*, introduced by Chairwoman Nydia Velazquez is another piece of legislation that would substantially promote credit union small business lending. H.R. 1849 would exempt the guaranteed and non-guaranteed portions of SBA 7(a) loans made by credit unions from the regulatory cap for business lending, providing greater capacity to make business loans. Furthermore, NAFCU supports the establishment of a credit union outreach program within SBA to increase credit union participation, as the red-tape and rising fees at the SBA have discouraged more credit unions from doing more SBA loans. NAFCU also believes that an 85 percent guaranty on member business loans up to $250,000 for loans made to small businesses in underserved areas will encourage more credit unions to make SBA loans in these areas. H.R. 1849 is a pivotal step toward facilitating more SBA loans by credit unions and thus encouraging greater credit union business lending. These proposals would undoubtedly benefit the entrepreneur and small business credit union members.

Business lending to our members has been very important for Mid-Hudson Valley Federal Credit Union. During the early 1990's the town of Kingston, New York and the Mid-Hudson Valley was left reeling from the closure of the IBM Kingston plant in town that employed over 7,000 people. As the federal credit union for the IBM plant, we have helped many former IBM employees establish their own small business ventures through small business loans. Many of these former IBM employees had to start their careers over from scratch. Some of the bigger financial institutions in the area were unwilling to make capital available to these entrepreneurs. As a result, Mid-Hudson Valley FCU stepped in and filled this niche market, providing countless small business loans that helped turn what could have been an economically devastating event into a success story. Today Mid-Hudson Valley FCU continues to help fuel small business growth in our region.

Credit card lending plays an integral role in providing much needed capital for our small business members to grow their companies. Currently, 61 MHVFCU business members have business credit card accounts with our credit union. This represents a total credit limit available of $600,000, of which $200,000 is in carried balances. The largest credit limit among these 61 businesses is $30,000. These small business members pay their bills regularly and on time and often do not carry balances and thus do not generate large amounts of interest income for MHVFCU. Absent the capital provided through credit cards these businesses surely would not be as successful as they are today and unemployment would likely be higher.

Credit Union Credit Card Practices

Credit cards offer a convenient form of payment and an easy way to track expenses. Many smaller companies and new start up businesses who find capital for business investment utilize credit cards as their main source of credit despite paying higher interest rates on these short term loans. Federal credit unions are the only federal financial institution with a statutory usury ceiling (currently 18%). This usury ceiling combined with the unique relationship that credit unions have with their members, ensures that small businesses using credit cards from their credit union do not face predatory interest rates for this valuable credit.

Federal credit unions have traditionally always been responsible lenders and have not participated in some of the predatory and egregious practices that other lenders have when it comes to credit cards. Thankfully, double cycle billing, universal default and hair trigger repricing are not a part of everyday federal credit union vocabulary.

Credit unions are proud that we have a solid and strong record of creating a safe and sound credit card lending environment for their members. Some facts about federal credit unions and their credit card practices are below:

- As member-owned financial institutions, federal credit unions are unique in that the products they offer are solely for the benefit of the members of the credit union.
- An extensive regulatory framework is also in place to ensure the safety and soundness of all lending practices that federal credit unions perform, including open-end credit granted through credit cards.
- Currently, approximately 50 percent of all federal credit unions offer their members credit card services.
- The growth rate of credit card lending by credit unions has averaged just 4 percent for the last five years, representing just over 5 percent of the total loan portfolio of credit unions.
- The average interest rate of all federally insured credit unions offering credit cards today stands at 11.91 percent (as of March 7, 2008). According to bankrate.com, one major credit card issuer stated the rate for some customers will increase to as much as 28 percent in 2008 regardless of credit history.
- Interest rates for credit cards offered by credit unions are capped at 18 percent because of the statutory usury ceiling on credit unions.
- The rate of consumers falling behind on their credit card payments is substantially lower at credit unions than at non-credit union lending institutions.
- Consumer complaints reveal few problems with credit cards issued by federal credit unions. A formal complaint process for credit union members monitored by the National Credit Union Administration (NCUA) ensures that credit unions remain member-friendly when it comes to credit card lending.

- NCUA has procedures in place to help members resolve any issues they may have with their credit union's lending practices. When a consumer complaint brings a violation to the regulator's attention, NCUA takes steps to strictly enforce applicable laws and regulations.

- Consumer Reports conducted a survey that focused on 21 credit card issuers. It found that credit unions' ranked higher in customer satisfaction than the five major credit card companies. According to the survey, median credit card rates were as much as 8% lower at credit unions than at other financial institutions.

- Member satisfaction is a priority for credit unions. Forrester Research found that credit unions beat banks two to one when consumers were asked which institution "does what's best for me, not what's best for its bottom line."

How Credit Cards Help MHVFCU Members

As stated earlier, federal credit unions, such as MHVFCU, are in a great position to lend to small businesses due to the established and continuing relationship and familiarity with the principles of current and potential small business owners. At Mid-Hudson Valley FCU, many of the loans that we make to small business owners are to people that have been members of the credit union for years. Knowing the operations and personnel that is behind a small business is crucial and really makes a difference when it comes to providing the best possible customer service to small businesses.

At MHVFCU, we tend to hear the same reasons over and over again as to why our members who own small businesses prefer credit cards to assist them with their business. The ease of obtaining a credit card, the ability to monitor cash flow, efficiency, fair rates and overall convenience are among the main reasons why our small business owners utilize credit cards to help fund business operations. Also knowing our members and their businesses helps us to put them in proper loan products for their business needs. For example, if they needed to purchase a copy machine for $5,000 then we would suggest a term loan as opposed to putting the purchase on the credit card. It would be a mistake for the business owners to put $5,000 on a credit card in order to purchase the machine as they will be billed mostly interest and the value of the machine will decrease rapidly while the loan amount would only decrease slightly.

With their permission, I have highlighted a few of MHVFCU's business members that use credit cards below. These are typical examples of small businesses across the country that benefit from their credit cards that they obtain from their credit union in the operation of their business on a daily basis.

- The Barn Raiser, LLC – This company has been a business member since December 2003. It was a start-up business that has been very successful. The Barn Raiser, LLC has a $20,000 limit on their credit card. This card has worked very well for them as their business has them on the road a lot with deliveries of their barns, also creating a need for remote services with working over the phone to continue to run their business while on the road. They appreciate the convenience of this type of credit as it assists them with their cash flow from month to month. Obtaining this type of credit is easier than other options as it is unsecured and therefore has no closing costs as a real estate loan or equipment loan would require.

  This member has a full relationship with MHVFCU. They have all of their business deposits with us, 4 accounts and 3 loans. They have a business line of credit in the amount of $100,000, an equipment loan and the credit card.

  Michelle Heitmann, the owner, said "*The credit card also allows us to monitor our monthly cash flow closely thereby allowing us to be more efficient."*

- Cutting Edge Landscaping of Orange County, Inc. – This company is a new business member to MHVFCU but the principals have had a long extensive relationship with MHVFCU as personal members. The company was started to meet the needs of their consumers and they use the card to order quickly over the phone and manage their cash flow on a monthly basis. Also, they are on the road extensively and this card allows them to either handle charges out of the office or handle charges over their cell phone from their truck as opposed to their office. Their total relationship is just over a million dollars and is a full business lending relationship with checking and savings accounts, merchant services, along with loans including a commercial mortgage, equipment loans, a line of credit and the credit card

  Mark Press, the owner said *"The credit card allows us to order supplies over the phone and we can manage our cash flow on a monthly basis. We work out of our truck on the road via a cell phone and the credit card allows us this flexibility and convenience."*

- Vinmar Homes, Inc. – This company has been a business member since January 2007 and they started with a $5,000 card limit and has grown to $15,000 currently. They have a construction company that builds and renovates houses. This credit card allows them the flexibility to order materials and handle their cash flow on a monthly basis. They currently have a business checking and savings account along with their credit card.

  Mark Jensen the owner stated " *This credit card allows us the flexibility to order materials and handle our cash flow on a monthly basis. Also, obtaining this type of credit was quick and inexpensive due to lack of closing costs."*

I discussed this hearing with these and other small business members of MHVFCU and the reasons that our business members gave as to why they prefer a credit card to assist with their business are:

1. Ease of obtaining – one page application, run a credit report then obtain approval. "It's simple and quick".
2. It forces them to review and monitor their cash flow monthly as that is when they are billed.
3. Allows them to be very efficient. They are constantly reminded of their limit and that they need to stay within the set parameters.

4. Fair rates with MHVFCU. When they compare our rates are considerably below the competition. We also offer Rewards if they so desire but basically they prefer the no frills credit card with a fair rate, fair monthly billing cycle, fair grace period and no annual fee.

5. Cards for employees are also available.

6. Convenience = many businesses can now order and work on-line via the internet and the business credit card allows them the speed of the internet.

7. Proper loan product for the proper business need. The typical small business usually requires a line of credit to handle their daily, weekly and monthly cash flows needs. In general, they order product and hopefully within 30 days have sold that product and can repay the credit card with the proceeds from that sale. If they have a need for a regular term loan then we would work with them on matching the proper loan product for their need. For example, if they needed to purchase a copy machine for $5,000 then we would suggest a term loan as opposed to a credit card. It would be a mistake to put the $5,000 for the copy machine on the credit card as they will be billed mostly interest only and the value of the machine will decrease rapidly while the loan amount will decrease slightly.

8. Inexpensive credit to obtain – no closing costs when compared to a traditional loan like an equipment loan or real estate backed loan.

9. Good place to begin building credit and building a business relationship with a financial institution.

Efforts to Legislate Certain Credit Card Practices

NAFCU recognizes that there is a need to reign in unscrupulous and predatory practices that some credit card issuers have used, although some well-intentioned efforts can have unintended negative consequences. There have been troubling legislative proposals introduced that would restrict credit card practices, regulate risk, and limit market driven interchange fees. We believe that any effort to rein in credit card practices should be carefully crafted to ensure that smaller financial institutions, particularly credit unions that fund small businesses with their best interest in mind are not unduly burdened by unnecessary regulation or unintentionally harmed by these legislative efforts.

A promising framework of solutions exists within the Federal Reserve's proposal to amend Regulation Z. The Federal Reserve's plan is intended to improve the effectiveness of consumer disclosures in regards to credit card accounts and other revolving credit plans. The plan would ensure that information would reach consumers in a timely manner and would be easy to comprehend. The disclosure of possible fees and penalties if a borrower is delinquent on payments would be a cornerstone of the proposal. These disclosures would accompany credit card applications and solicitations, while also highlighting fees and the reasons penalty rates may be applied. Creditors would be required to summarize key terms at the opening of a new account and when any terms of the agreement are changed. Furthermore, the proposal would also expand the circumstances under which consumers receive written notice of changes in terms to their accounts, including requiring an advance notice before a penalty is invoked and would increase the amount of time these notices must be sent before the change becomes effective.

Many of the proposals before Congress call for the implementation of the amendments to Regulation Z that the Federal Reserve is considering. While NAFCU is supportive of, and many credit unions already comply with, many of these proposals, we are wary of inflexible and unnecessary additional regulatory burdens being placed upon good actors such as credit unions. Credit unions are more heavily regulated than any other consumer financial services provider. Restrictions on the operations of credit unions limit not only who can avail themselves of credit union services, but also how credit unions can raise capital. Any time additional compliance burdens are placed upon federal credit unions the operations of these institutions are severely impacted and usually come at the expense of member services. We urge Committee members to keep this in mind when considering any proposals concerning credit cards and consider any detrimental impact it may have on smaller financial institutions such as federal credit unions, specifically in terms of impacting small business lending.

Many members of Congress have called for patience before enacting any legislation that would essentially mirror the Federal Reserve's proposals. NAFCU believes this to be a prudent course of action and encourage members of the Small Business Committee to consider all aspects of any proposal and the potential unintended consequences on smaller financial institutions.

Conclusion

In conclusion, federal credit union small business lending is strong and continues to grow. However, the current regulatory framework prevents federal credit unions from doing more for America's small businesses. Legislative proposals such as the *Credit Unions Small Business Lending Act* and provisions pertaining to member business lending limits contained in the *Credit Union Regulatory Relief Act* would go a long way in helping credit unions to bolster small business growth across America.

Furthermore, credit card lending plays a pivotal role in helping federal credit union business members start and grow their small businesses. Any proposals that could increase the cost of credit card lending and limit access to capital would essentially hurt small business development in America. NAFCU urges caution and careful consideration of any proposals that could simultaneously hurt credit union lending and small business development. America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident and productive purposes." Credit card and small business lending are two ways in which federal credit unions carry this mission out. I thank you for your time and I am happy to field any questions that the Committee members may have. Thank you.