

2006-2005

Consolidated Financial

*Report*



# 2006's Capital Achievements

In many respects, 2006 was a pivotal year for NAFCU and credit unions. Not only did the association continue serving the credit union community in all the ways members have come to expect, but NAFCU took part in a number of key developments that may mark a turning point for credit unions and their members.

Perhaps the most significant among these was the final passage and enactment of the Financial Services Regulatory Relief Act in October. As the first regulatory relief law for credit unions in decades, the bill was a legislative victory for NAFCU and a clear sign that years of lobbying on the issue had paid off.

While the bill did not contain all the provisions sought by NAFCU, it did feature four key relief measures for credit unions. Specifically, the law authorizes credit unions to provide check-cashing, funds transmittals and monetary instruments to nonmembers in their fields of membership; protects credit union net worth under pending Financial Accounting Standards Board rules on mergers; raises the 12-year loan limit to 15 years; and permits credit unions to lease land on Department of Defense facilities at a nominal cost. In addition, starting in 2012, all financial institutions will earn a return on the reserves they maintain with the Federal Reserve on transaction accounts. Overall, the law represented a critical first step toward achieving broader relief.

Another welcome development was the NCUA's findings from its data collection pilot. A response to a 2005 House Ways and Means hearing on credit unions' tax exemption, the pilot showed that credit unions are serving who they are chartered to serve—working people. The NCUA's report documented the many ways credit unions reach out to their members with convenient, low-cost services tailored to meet their specific financial needs.

A separate study, conducted by the Government Accountability Office at the behest of former House Ways and Means Committee's Chairman, Bill Thomas, also contained some good news. It suggested there is no need to rescind credit unions' tax-exempt status or subject credit unions to Community Reinvestment Act-type regulations. While NAFCU welcomed the GAO's finding that credit unions are offering their services at lower cost than other financial institutions, the association noted that the report omitted some key findings, such as Home Mortgage Disclosure Act data which show credit unions approve a greater percentage of mortgage loans to people of lower household incomes.



*NAFCU President Fred Becker visits with Rep. Jeb Hensarling, R-Texas.*

NAFCU also worked in numerous ways to respond to bankers' attacks on credit unions and their ability to serve members, particularly those in underserved areas. Since January 2006, the NCUA has limited underserved-area expansions to multiple common bond credit unions. The new prohibition was in response to a bankers' lawsuit



NAFCU Board Chair John Milazzo greets Rep. Patrick McHenry, R-N.C.

that contended the 1998 Credit Union Membership Access Act bars single-group and community-chartered credit unions from adding underserved areas to their fields of membership. NAFCU's work ensured that those federal credit unions already serving underserved areas could continue to do so, despite the moratorium on new underserved-area expansions.

2006 was also marked by several key developments on the regulatory and security front. NAFCU stepped up its usual efforts to educate

credit unions on Bank Secrecy Act issues, holding two webcasts on the topic and unveiling a new newsletter, *BSA Blast*, which provides members with the latest compliance information available. NAFCU also continued to inform members about important industry news and other information via its weekly *UPDATE* newsletter, daily *NAFCU Today* e-mails, and its bimonthly publication, *The Federal Credit Union*.

Education sessions, industry developments and other hot credit union topics were also an integral part of most of NAFCU's conferences last year, including the Annual Conference & Exhibition in Toronto, Canada, which drew some 2,000 representatives from the credit union industry. Not only did the conference keep attendees informed about the latest information affecting the credit union world, it provided a forum for networking and developing new business relationships.

NAFCU also helped facilitate important developments aimed at protecting military service members from predatory lending practices. The DoD adopted an instruction in July that, as long urged by NAFCU, tightens the rules for solicitations of on-base military personnel. In addition, the president signed into law a NAFCU-backed measure that bars the sale of mutual fund contracts to military service members and strengthens oversight of the sale of insurance products. Further, the DoD issued a report documenting the harm that predatory lenders have on the military community and recognized the good work on-base credit unions do in combating these practices.

NAFCU/PAC also remained a priority for the association, with \$397,596 raised during the 2005-2006 election cycle. In September, the association's Congressional Caucus brought some 400 credit union representatives to Capitol Hill to meet with lawmakers on key issues. Importantly, more than 90 percent of the 152 candidates NAFCU/PAC contributed to won in November's elections.

In addition, the NAFCU/Fannie Mae alliance was revamped in 2006 to make it easier for NAFCU members to provide more affordable mortgage services to credit union members. Now, association members receive better pricing in the secondary market for fixed-rate mortgages, including biweeklies, and a 40-year mortgage for credit unions that elect to deliver a set percentage of their secondary market sales to Fannie Mae.

Ultimately, NAFCU's work in 2006 once again demonstrated what lies at the heart of the credit union community: service. As the industry continues to evolve and new developments take place, NAFCU will continue working diligently to provide its members with the best service imaginable, celebrating further legislative successes, continuing to ward off bankers' attacks, and ensuring that credit unions have all the tools and information they need to serve their members and communities.



# NAFCU Chair & President's Report

Looking back at 2006, it's hard not to be amazed at how much happened in the credit union world and how our industry evolved during those 12 months. Through it all, NAFCU remained in the forefront, ensuring credit unions had the information, representation and tools they needed to adapt to these developments and stand tall for their members.

We are proud of last year's passage of the Financial Services Regulatory Relief Act, which gave credit unions their first taste of regulatory relief in decades. NAFCU views the law as a positive first-step toward achieving much broader, widespread relief from onerous and unnecessary regulations that limit credit unions' ability to serve their members.

2006 was also a year when data collection to establish credit union service became a central issue. Credit unions rose to meet the challenge though, as NCUA's staff and the GAO both told us what we've known for years: Credit unions serve who they are chartered to serve—working people.

Another report by the Department of Defense described how damaging payday lenders are to our military men, women and families. We were particularly pleased that the DoD's report reiterated what FDIC Chairman Sheila Bair said in a study on payday lending for the Anne E. Casey Foundation: Credit unions are actively battling these lenders through financial education programs and by offering alternative short-loan products at more reasonable costs.

Data security was also a key issue in 2006, with numerous, and often large, breaches reported throughout the year. Bank Secrecy Act updates were issued and NAFCU was there to assist credit unions in their compliance efforts. Our new *BSA Blast* newsletter, which we introduced in 2006, has become quite popular with NAFCU members, and the two webcasts we sponsored on BSA last year were very well-received.

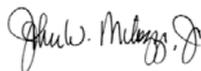
Finally, it was a historic year for NAFCU/PAC, and NAFCU members deserve much of the credit for this.

In the end, NAFCU/PAC raised \$397,596 during the 2005-2006 election cycle, with more than 90 percent of the 152 candidates NAFCU/PAC contributed to winning in November's elections.

Indeed, 2006 was clearly a year where NAFCU and credit unions were put to the test and responded with flying colors. As we prepare this report, NAFCU is in the midst of tackling a number of important issues in the first quarter of 2007. Chief among these is addressing the issue of hostile mergers and the potential adverse effect of such activities on the credit union community. The association is also continuing to work hard on obtaining additional regulatory relief measures and is actively involved in bolstering financial literacy efforts to help credit unions thwart payday lenders.

As always, NAFCU values your thoughts and opinions and would like to hear from you. We remain committed to your needs and will continue to do everything in our power to champion the federal credit union cause. Please feel free to contact us at any time.

John Milazzo



NAFCU Board Chair



Fred Becker



NAFCU President and CEO



# NAFCU Services Corporation Report

Clearly 2006 was an important year for NAFCU Services Corporation, NAFCU's wholly owned subsidiary. Not only was it one of the most successful years for us from a financial standpoint, but the latter half of 2006 marked a shift away from a purely products and services-based approach to a solutions-based philosophy. This change of focus has made the company even more effective at offering credit unions the best resources available to deal with the tough, everyday problems they face.

Last year, we added four new preferred partner relationships: anti-phishing and online card fraud monitoring services (Cyveillance); qualified retirement plans (Pentegra); charged-off debt purchasing (Hudson and Keyse); and multi-factor authentication (BioPassword).

In addition, we are pleased to report that BancServices Group has expanded its product offerings to include Core Xcelerator and Equifax Decision Power Express. NAFCU Services' Preferred Partner program now offers 34 different products/services through 28 companies. Most importantly, all of these products provide unique NAFCU-member credit union discounts or value-added benefits.

NAFCU Services Corporation's Preferred Partners deserve recognition for their continued support of NAFCU's member credit unions and NAFCU Services Corporation. NAFCU Services' parent company, NAFCU, and NAFCU Services Corporation's Board of Directors should also be recognized for their guidance and direction, and the NAFCU Services' staff thanked for their diligent work and continued assistance throughout the year.

NAFCU Services' Products/Services Advisory Committee remains an integral part of the company's success. This

group of representatives from NAFCU-member credit unions is comprised of a cross-section of various senior management positions, asset sizes and geographic areas throughout the country. The focus and commitment of the committee members are among the primary reasons why NAFCU Services continues to offer critical product offerings from the credit union industry's finest vendors.

This year we are more confident than ever before that our group of highly qualified and carefully selected vendors will clearly demonstrate why they have earned the designation of NAFCU Services Preferred Partner.

We thank you for your continued support and look forward to a successful 2007.

Fred Becker



NAFCU Services  
Corporation Chair



David Frankil



NAFCU Services  
Corporation President



# NAFCU Treasurer's Report

It is with great pleasure that I tell you NAFCU has once again succeeded in building on past financial successes. In 2006, NAFCU's equity increased by \$292,123 while its assets grew by \$683,574, marking the association's 18th consecutive year of sustained financial stability and growth.

NAFCU could not have achieved such healthy growth in 2006 without the continued support and participation of the association's members. Thanks to them, we have continued to bolster our efforts on Capitol Hill to address bankers' attacks. In addition, NAFCU Services Corporation, the association's subsidiary, continues to demonstrate its value through contributions to NAFCU's members and to the association itself.

Simply put, NAFCU could not have accomplished what it did last year without the loyalty of its members or the prudent management of its expenses. Of course, the association's staff should also be recognized for successfully adhering to the board's approved budget throughout the year. It is the intent of NAFCU's board and management to always provide the highest quality services relative to the dues received.

As with previous years, all of NAFCU's financial decisions in 2006 were consistent with the short- and long-term goals of the association and have strengthened the financial stability of your association. I would like to thank NAFCU's member credit unions, its board of directors, member volunteers, management and staff for their guidance, support and cooperation.

It is through our commitment to working together that we have been able to strengthen the association both financially and in its ability to enhance the federal credit union charter. NAFCU continues to be well positioned to achieve its objectives for the future and to enhance the benefits of membership.

Mike Lussier



NAFCU Treasurer



# Independent Auditor's Report

We have audited the accompanying consolidated statements of financial position of the National Association of Federal Credit Unions, Inc. and Affiliates (the Organization) as of December 31, 2006 and 2005, and the related consolidated statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the

accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the National Association of Federal Credit Unions, Inc. and Affiliates at December 31, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



Washington, DC  
February 28, 2007

# Consolidated Statements of Financial Position

	<b>Year Ended December 31,</b>	
	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
Cash and cash equivalents - Note B	\$ 1,085,636	\$ 856,010
Accounts receivable	179,403	259,617
Prepaid expenses and other assets	390,808	326,929
Investments - Notes B & C	7,830,965	7,059,267
Property and equipment, at cost		
Land	1,309,226	1,309,226
Building and improvements	5,166,082	5,159,406
Furniture and equipment	1,462,885	1,440,331
	<u>7,938,193</u>	<u>7,908,963</u>
Less accumulated depreciation and amortization	(3,804,665)	(3,474,020)
	<u>4,133,528</u>	<u>4,434,943</u>
<b>Total assets</b>	<u><u>\$13,620,340</u></u>	<u><u>\$12,936,766</u></u>
<b>Liabilities and Net Assets</b>		
<b>Liabilities</b>		
Accounts payable and accrued expenses	\$ 638,555	\$ 600,567
Deferred revenue	4,740,551	4,387,088
Tenant deposits	13,222	13,222
Total liabilities	<u>5,392,328</u>	<u>5,000,877</u>
<b>Net assets</b>		
Unrestricted	7,853,179	7,467,871
Temporarily restricted - Note D	374,833	468,018
Total net assets	<u>8,228,012</u>	<u>7,935,889</u>
Commitments and contingencies - Note G	-	-
<b>Total liabilities and net assets</b>	<u><u>\$13,620,340</u></u>	<u><u>\$12,936,766</u></u>

*See accompanying notes to the consolidated financial statements, pages 9-10*

# Consolidated Statements of Activities

	Year Ended December 31,	
	2006	2005
<b>Changes in unrestricted net assets</b>		
Revenue		
Membership dues	\$ 6,653,667	\$ 6,422,489
Member educational conferences	2,581,496	2,448,928
Service fees	1,046,076	1,199,429
Products and services	513,393	559,979
Interest income - Note C	338,537	194,546
Advertising	248,084	237,691
Other	196,659	210,424
Rental income	108,347	105,564
	<u>11,686,259</u>	<u>11,379,050</u>
Net assets released from restriction	538,747	456,346
	<u>12,225,006</u>	<u>11,835,396</u>
Expense		
Program services:		
Membership educational conferences	2,101,125	2,044,530
Communications and publications	655,000	612,905
Legislative, regulatory and compliance	197,733	202,920
Products and services	104,672	90,518
Officials and committees	91,689	110,607
Membership	70,684	63,419
Donations - Katrina	68,752	100,000
	<u>3,289,655</u>	<u>3,224,899</u>
Supporting services - Note F		
Administration and overhead	7,964,930	7,415,733
Building and occupancy	565,418	570,703
	<u>11,820,003</u>	<u>11,211,335</u>
Change in unrestricted net assets before income taxes	405,003	624,061
Income tax expense	(19,695)	(17,488)
Change in unrestricted net assets	<u>385,308</u>	<u>606,573</u>
<b>Changes in temporarily restricted net assets</b>		
Contributions	444,489	511,908
Interest income - Note C	1,073	1,143
Net assets released from restriction	(538,747)	(456,346)
Change in temporarily restricted net assets	<u>(93,185)</u>	<u>56,705</u>
<b>Changes in net assets</b>	292,123	663,278
Net assets, beginning of year	7,935,889	7,272,611
<b>Net assets, end of year</b>	<u>\$ 8,228,012</u>	<u>\$ 7,935,889</u>

See accompanying notes to the consolidated financial statements, pages 9-10

# Consolidated Statements of Cash Flows

	Year Ended December 31,	
	2006	2005
<b>Cash Flows From Operating Activities</b>		
Change in net assets	\$ 292,123	\$ 663,278
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	413,017	457,370
Changes in assets and liabilities:		
Accounts receivable	80,214	6,021
Prepaid expenses and other assets	(63,879)	93,404
Accounts payable and accrued expenses	37,988	107,104
Deferred revenue	353,463	159,957
Tenant deposits	-	-
Total adjustments	<u>820,803</u>	<u>823,856</u>
Net cash provided by operating activities	<u>1,112,926</u>	<u>1,487,134</u>
<b>Cash Flows From Investing Activities</b>		
Net purchase of investments	(771,698)	(1,228,022)
Net purchases of property and equipment	(111,602)	(201,874)
Net cash used in investing activities	<u>(883,300)</u>	<u>(1,429,896)</u>
<b>Net increase in cash and cash equivalents</b>	<b>229,626</b>	<b>57,238</b>
Cash and cash equivalents, beginning of year	<u>856,010</u>	<u>798,772</u>
<b>Cash and cash equivalents, end of year</b>	<b><u>\$ 1,085,636</u></b>	<b><u>\$ 856,010</u></b>
<b>Supplemental Disclosure of Cash Flow Information</b>		
Cash paid during the year for income taxes	<u>\$ 1,200</u>	<u>\$ 26,676</u>

See accompanying notes to the consolidated financial statements, pages 9-10

# Notes to the Consolidated Financial Statements

## A. Organization and Summary of Significant Accounting Policies

**Organization:** The National Association of Federal Credit Unions, Inc. (the Association), located in the Washington, D.C. area, is the only trade association which exclusively serves federally chartered credit unions. Founded in 1967, the Association's primary purpose is to represent its members before Congress and the federal regulatory agencies. The Association also provides its members with a source of reliable information through its publications, educational programs, regulatory compliance assistance, and economic research. The Association's members are among the most progressive institutions in the industry.

The Association's wholly-owned for-profit subsidiary, NAFCU Services Corporation (NSC), is incorporated in the District of Columbia. NSC was organized to provide consulting and marketing efforts for various services offered by vendors to the credit union community.

A trust agreement was drawn by NSC on September 25, 1975 (amended March 2, 1977) to provide for the establishment of individual trusts by credit unions in the United States and its possessions, with such credit unions being the grantors and Union Bank being the Trustee. This plan of Common Trust is known as the National Investment Fund for Credit Unions (NIFCUS). NSC receives fees from the Trustee (Union Bank) in return for advice and assistance concerning credit union regulations and participation.

The National Association of Federal Credit Unions Political Action Committee (the PAC) was organized to conduct political activities on behalf of the Association's members.

The National Association of Federal Credit Unions Foundation for Charitable, Literary, Educational and Humanitarian Purposes (the Foundation) was incorporated in April 1995 in the Commonwealth of Virginia. The purpose of the Foundation is to promote charitable, literary, educational and humanitarian causes of interest to credit unions and those associated with them.

**Income tax status:** The Association is exempt from the payment of income taxes on its exempt activities under Section 501(c)(6) of the Internal Revenue Code. Under the Code, advertising revenue earned in the publication of the Association's magazine and other income earned from NSC are subject to unrelated business income taxes.

The PAC is a separate segregated fund as defined under Section 527(f)(3) of the Internal Revenue Code. As such, the PAC is subject to income taxes on the lesser of its exempt activity expenditures or investment income.

The Foundation is exempt from the payment of income taxes on its exempt activities under Section 501(c)(3) of the Internal Revenue Code. The Foundation has been classified as other than a private foundation by the Internal Revenue Service.

NSC is a taxable corporation. The provision for income taxes is based on reported income adjusted for differences that will never enter into the determination of taxable income under applicable tax laws.

**Principles of consolidation:** The consolidated financial statements include the accounts of the Association, NSC, the Foundation, and the PAC. Significant inter-company accounts and transactions have been eliminated in consolidation. For purposes of these consolidated financial statements, the entities are referred to collectively as the Organization.

**Basis of accounting:** As required by U.S. generally accepted accounting principles (GAAP), the Organization prepares its financial statements on the accrual basis of accounting. Revenue is recognized when earned and expense when the obligation is incurred.

**Use of estimates:** The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from estimates.

**Cash and cash equivalents:** For financial statement purposes, the Organization considers all money market funds, certificates of deposit, and US agency and treasury obligations to be other than cash equivalents.

**Accounts receivable:** Accounts receivable consist primarily of amounts owed from NSC Preferred Partners as a result of royalty/marketing agreements. Accounts receivable are presented at the gross, or face, amount due to the Organization. The Organization's management periodically reviews the status of all accounts receivable balances for collectibility. Each receivable balance is assessed based on management's knowledge of the customer, the Organization's relationship with the customer, and the age of the receivable balance. As a result of these reviews, customer balances deemed to be uncollectible are charged directly to bad debt expense. Management believes that the use of the direct write-off method approximates the results that would be presented if an allowance for bad debts was recorded.

**Property and equipment:** Acquisitions of property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the following useful lives of the various classes of assets:

Building and improvements	5 - 29 years
Furniture and equipment	3 - 7 years

**Deferred revenue:** Deferred revenue principally consists of membership dues, subscriptions, and conference/seminar payments received in advance. Membership dues and subscriptions are recognized as revenue over the duration of the related membership or subscription. Conference and seminar registration fees are recognized as revenue once the related meeting has taken place.

**Net assets:** For financial statement purposes, net assets are as follows:

**Unrestricted:** Unrestricted net assets are available for general operations.

**Temporarily restricted:** Temporarily restricted net assets represent the portion of net assets that have been restricted by donors (see Note D).

**Contributions:** Contributions are recorded as unrestricted or temporarily restricted support depending upon the existence and/or nature of any donor restrictions. Support that is not restricted by the donor is reported as an increase in unrestricted net assets. Donor-restricted support is reported as an increase in temporarily restricted net assets and then reclassified to unrestricted net assets when the restriction expires.

**Functional reporting of expenses:** The Organization reports the direct costs of operating its programs as "program services" expense on the statement of activities. All salaries, occupancy, and administrative costs are reported as supporting services on the statement of activities.

## B. Concentrations

**Credit risk:** The Organization maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Organization has not experienced any such losses in the past, and does not believe it is exposed to any significant financial risk on these cash balances.

**Market risk:** The Organization also invests funds in fixed income securities and mutual funds that contain various types of marketable securities. Such investments are exposed to various risks, such as fluctuations in market value and credit risk. Thus, it is at least reasonably possible that changes in these risks in the near term could materially affect investment balances and the amounts reported in the financial statements.

## C. Investments

Investments are carried at fair value. Investments consist of the following as of December 31:

	2006	2005
Money market funds	\$ 1,048,681	\$ 950,700
US agency and government obligations	4,759,682	4,111,529
Commercial paper	2,022,602	1,997,038
	<u>\$ 7,830,965</u>	<u>\$ 7,059,267</u>

The following is a summary of the investment return for the years ended December 31:

	2006	2005
Interest income	<u>\$ 339,610</u>	<u>\$ 195,689</u>

## D. Temporarily Restricted Net Assets

Temporarily restricted net assets consists of the following at December 31,:

	2006	2005
NAFCU PAC Administration	\$ 374,833	\$ 415,619
Hurricane Katrina fund	-	52,399
	<u>\$ 374,833</u>	<u>\$ 468,018</u>

## E. Retirement Plans

The Association and NSC maintain a defined contribution retirement plan covering substantially all full-time employees who meet certain age and length of service requirements. Employees are fully vested on attaining five years of service. Retirement expense charged to operating expenses in 2006 and 2005 was \$303,130 and \$288,749, respectively.

## F. Supporting Services

The major components of the Organization's consolidated supporting service expenses consist of the following for the years ended December 31, 2006 and 2005:

	2006	2005
Employee compensation and benefits	\$5,795,843	\$5,550,028
Building operations	565,418	570,703
Depreciation	172,581	217,100
Professional services	472,360	312,666
Other	1,524,146	1,335,939
	<u>\$8,530,348</u>	<u>\$7,986,436</u>

## G. Commitments and Contingencies

The Organization leases a portion of its headquarters building under operating leases which expires through 2009.

The future minimum payments to be received under the operating leases are as follows:

Year Ending December 31,	Amount
2007	\$ 78,139
2008	47,116
2009	48,378
	<u>\$173,633</u>

## *NAFCU Board of Directors*

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