National Association of Federal Credit Unions
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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

November 18, 2015

Mr. Daniel Smith
Assistant Director
Office of Financial Institutions
Consumer Financial Protection Bureau
1700 G Street NW
Washington, D.C. 20552

RE: Credit union concerns with a future payday lending rulemaking

Dear Mr. Smith:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the Outline of Proposal's Under Consideration for payday, vehicle title, and similar loans released on March 26, 2015, by the Consumer Financial Protection Bureau (CFPB). While NAFCU supports the CFPB's objective of preventing consumers from becoming entangled in predatory payday lending debt traps, NAFCU has serious concerns with the limitations the Bureau is considering on short-term, small-amount loans offered by federal credit unions and other insured depository institutions.

General Comments

NAFCU supports the CFPB's mission to bolster consumer protections in an effort to eliminate the ability of predatory payday lenders to continue trapping consumers in cycles of debt they have little hope of exiting. These unscrupulous actors need to be thoroughly regulated. In addition, NAFCU looks forward to working with the Bureau to ensure consumers have access to borrowing options from reputable lenders, like credit unions, whenever possible.

As the Bureau is aware, NAFCU and a few of our members met with the CFPB's regulations staff on June 11, 2015, to discuss the credit union industry's perspective on the Bureau's outline

of payday rulemaking ideas. Since that meeting, we have continued to gather feedback from credit unions on the Bureau's future rulemaking regarding the payday lending space. As the Bureau learned from the June meeting and others, the credit union industry was founded on the notion of "people helping people" and is dedicated to serving its members. The relationship between the credit union and its member is based on fairness and responsible practices. NAFCU and our member credit unions believe that a blanket rule regulating all parties indiscriminately – good actors and bad actors alike – is likely to hinder the ability of credit unions to serve their members' financial needs. We strongly urge the CFPB to carefully craft any future rulemaking to ensure credit unions are not forced to withdraw from providing a viable alternative to predatory payday lenders. For this reason, NAFCU recommends any future payday rulemaking promulgated by the Bureau include an express exemption for federal credit unions and other insured depository institutions conducting short-term, small-amount loans in accordance with current state or federal laws, such as the National Credit Union Administration's (NCUA's) Payday Alternative Loan (PAL loan) program.

Credit Unions are responsible lending institutions.

Credit unions are different than most other types of financial institutions. Since the Great Depression, the credit union industry has abided by the motto that credit unions are "not for profit, not for charity, but for service" and this philosophy continues to the present. Credit unions exist for the primary purpose of serving their membership. As member-owned not-for-profit cooperatives, credit unions consistently strive to provide their members with financial products and services designed to help each member achieve their individual financial needs and goals.

Credit unions are dedicated to helping their members avoid predatory payday lenders by providing responsible short-term, small-amount loans in addition to financial education resources that assist the member in developing sound debt management skills. Therefore, it is critical that the Bureau avoid any rulemaking that unjustifiably restricts the ability of credit unions to provide their members with sensible credit options for unexpected expenses as well as everyday needs.

PAL Loans were structured to protect members from high-cost predatory payday loans.

PAL loans were purposefully crafted to include beneficial features that protect borrowers while remaining considerably cheaper than other payday loans in the market. In 2010, NCUA amended its general lending regulation to enable federal credit unions to conduct short-term, small-amount loans, also known as PAL loans. The NCUA Board conducted a thorough examination of the payday lending space and issued a final rule to permit federal credit unions to offer their members a reasonable alternative to high-cost payday loans in a safe and sound manner. For over five years the PAL loan program has been successful and available to credit union members as a fair, carefully regulated, and cost-effective alternative to predatory payday loans.

Unlike predatory payday lenders, who have profited from a lack of oversight, credit unions already abide by a regulatory scheme that ensures members are not subjected to exorbitant fees

and abusive repayment schedules. NCUA has created a model to be followed for small-dollar lending and the Bureau is wise to base its longer-term loan "alternative option" on the PAL loan program. NCUA's program was designed to provide detailed limits on loan terms, such as prohibiting roll-overs, and requires the federal credit union to implement appropriate underwriting guidelines to minimize risk. Furthermore, PAL loans are only available to individuals who have been a member of the credit union for a minimum of 30-days and federal credit unions are required to verify the borrower's employment by having the member produce at least two recent pay stubs.

In addition, many credit unions have voluntarily created supplementary programs that provide members with additional resources and benefits. For example, it is common for credit unions to have programs in place that encourage saving, offer or even require financial education, and promote the building of credit through the reporting of PAL loan payments to credit bureaus.

Each credit union's short-term, small-amount lending program is specifically tailored with its individual field of membership in mind. In many cases, credit unions have built their PAL loan programs in direct response to members becoming victimized by predatory payday lenders. For example, a NAFCU member credit union with a large number of military members has created a low-to-no interest loan program with the application fee set at less than a third of the permissible $20 fee. At the same time, another NAFCU member conducts short-term, small-amount loans at an 18 percent Annual Percentage Rate (APR) while limiting the loan amount to a maximum of 25 percent of the member's monthly income. Even still, a state-chartered NAFCU member offers financial counseling information with every product, requires the member to be in good standing, and limits the loan amount to 20 percent of the member's monthly income. Each credit union's short-term, small-amount loan program begins and ends with the goal of offering members an option to obtain emergency funds without being exploited by predatory payday lenders.

Unreasonable limitations will push credit unions out of the market to the detriment of consumers.

According to the CFPB's outline, the Bureau is currently considering the addition of a number of restrictions on longer-term payday loans. The CFPB defines a "longer-term loan" as a loan with a maturity greater than 45 days with an *all-in* APR in excess of 36 percent. Although a 36 percent APR at first glance is well-above both the federal credit union general usury cap of 18 percent and PAL loan-specific interest rate cap of 28 percent, the use of an "all-in APR" would likely bring many credit union programs within the scope of "longer-term loans." These longer-term loans would be subject to extensive "ability-to-repay" standards before the loan is extended and strict presumptions of the inability-to-repay after the initial loan is extended. As mentioned briefly above, the CFPB is also considering the creation of an "alternative option" for longer-term loans that is largely based on the basic structure of NCUA's PAL loan program. However, the "alternative option" includes two important deviations from the program created by NCUA. Specifically, lenders would be required to conduct a verification of income and the borrower would be limited to <u>two</u> covered longer-term loans within a rolling six-month period. In contrast,

NCUA regulations currently allow a federal credit union to extend three PAL loans within a rolling six-month period.

Income Verification Requirement

Since PAL loans are often used as a means to obtain desperately needed funds during emergency situations, the inevitable delays caused by the need for a lender to obtain additional income documentation from the borrower could cause the member to experience inconvenience and frustration. Federal credit unions offering PAL loans are already required to develop "minimal underwriting standards that account for a member's need for quickly available funds, while adhering to principles of responsible lending." As previously mentioned, that process includes "obtaining proof of employment or income, including two recent paycheck stubs." A more extensive income verification requirement is likely to increase the length of time and amount of cost required to process a short-term, small-amount loan. Increased processing costs would potentially result in a reduced availability of these sensibly priced products. In some cases, the increased costs may be so significant as to deter some credit unions from offering these products altogether.

Reduction in Number of Available Loans

While the reduction in the number of loans available in a rolling six-month period from three to two may appear to be de minimis, NAFCU and our member credit unions believe any limitation on the ability of credit unions to serve their members is unreasonable. The CFPB dismisses these concerns in its outline, stating: "The restriction on the number of loans in a six-month period could have an impact on the revenue of federal credit unions that make these loans; the bureau believes these impacts would not be substantial." This statement neither provides a clear rationale nor does it contain any reasonable justification for the decrease in available loans. Yet, the reduction represents one less opportunity for a credit union to assist a member in need. In such cases, the impact is substantial to the member, who may be left with few options outside of falling behind on bills or borrowing money from unregulated sources.

In addition, many short-term, small-amount loans conducted by credit unions are offered strictly as a service for the benefit of members, not as profit centers. For example, a NAFCU member reported the typical net income on a PAL loan is barely above $20 and additional limitations will likely force this credit union to discontinue its program. These loans provide credit unions with a significant opportunity to work with the member in order to get them back into traditional financial products and away from the predatory actors. The potential decrease in the number permissible loans within a six-month period would certainly create challenges for credit unions and the result will likely be fewer short-term, small-dollar loans available to consumers from credit union lenders.

From a consumer perspective, decreasing the number of PAL loans available to the borrower within a rolling six-month period may have unintended consequences. NAFCU has received feedback indicating that limits on the number of PAL loans available to a borrower sometimes results in that borrower increasing his or her loan amount to greater than their immediate

financial need in an effort to create a safety net for unexpected expenses. Under NCUA's three loan limit, a consumer has less pressure to follow that type of borrowing behavior. However, if the Bureau were to move forward with one less loan for the member to "rely on," then it is likely maximization of borrowing would be reinforced. NAFCU is concerned the CFPB's limitation on PAL loans runs the risk of creating an incentive for consumers to borrow in greater amounts on their first short-term, small-amount loan.

Payment collection restrictions will be overly burdensome.

The CFPB is also considering limitations on a lender's ability to collect payment from a borrower on a payday loan. Specifically, lenders would be required to provide advanced written notice prior to any attempt to collect payment from a consumer's checking, savings, or prepaid account. In addition to the notice requirement, the Bureau is also considering limiting the number of unsuccessful collection attempts that a lender can make to two consecutive attempts before the lender would be required to obtain a new payment authorization from the borrower.

An advanced notice requirement before a lender is permitted to collect a payment on a payday loan is likely to prove unworkable and cost-intensive. NAFCU believes these requirements are inappropriate as borrowers are typically provided detailed repayment terms at the time of origination and the costs associated with advanced written notices are likely to outweigh any benefits to the consumer.

Credit union recommendations for a future payday lending rulemaking.

NAFCU and our member credit unions support the CFPB's goal of protecting consumers from the dire financial consequences that often result from becoming entangled with predatory payday lending. However, as the CFPB has repeatedly acknowledged, federal credit unions and other insured depository institutions are not the bad actors in this space. NAFCU believes the Bureau should focus its future payday lending rulemaking on the largely unregulated predatory payday lenders who have repeatedly placed consumers into financial harm through the use of cascading fees and excessive interest rates.

With that goal in mind, NAFCU puts forth the following recommendations to ensure the continued existence of credit unions as an alternative to predatory payday lending:

1. Any future rulemaking regulating payday lending should include an **express exemption** for federal credit unions and other insured depository institutions conducting short-term, small-amount loans in accordance with current state or federal laws, such as NCUA's PAL loan program.

2. Barring an express exemption, any future rulemaking regulating payday lending should exclude from the "all-in" APR calculation any application fee charged by a federal credit union or an insured depository institution when making a short-term, small-amount loan.

   a. A similar exclusion for application fees was adopted by the Department of Defense's recently finalized *Military Lending Act* (MLA) regulation. *See* 80 FR 43559 (July 22, 2015).

3. Barring an express exemption or exclusion for application fees, any future rulemaking regulating payday lending should include an "alternative option" modeled after NCUA's PAL loan program that matches the exact requirements of the PAL loan program.
   a. Specifically, the Bureau should allow "alternative option" lenders to extend three loans within a rolling six-month period and conduct underwriting consistent with current practices under NCUA's PAL loan regulation.

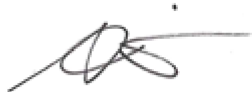
4. Any future rulemaking regulating payday lending should not include costly and burdensome restrictions on the ability of lenders to collect payment on payday loans.

Conclusion

Credit unions want to continue to provide their members with responsible financial products and services. While there must be adequate consumer protections to address the predatory practices of traditional payday lenders, NAFCU recommends that the Bureau avoid creating any unworkable burdens on credit unions that could prevent them from continuing to fairly and responsibly serve their members.

NAFCU appreciates the opportunity to share its thoughts on a future payday lending regulation. Should you have any questions or concerns, please feel free to contact me at amonterrubio@nafcu.org or (703) 842- 2244.

Sincerely,



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