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National Association of Federally-Insured Credit Unions

August 2, 2018

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Payday Alternative Loans (RIN 3133-AE84)

Dear Mr. Poliquin,

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing in response to the National Credit Union Administration's (NCUA) proposed rulemaking on payday alternative loans (PALs). NAFCU and its members appreciate the NCUA's proactive approach toward strengthening an important lending option for credit union members. Credit unions are responsible lenders that provide short-term, small-dollar loans to meet the demands of their members while remaining consumer friendly. NAFCU believes that providing additional short-term, small-dollar loan options will help curtail the predatory practices of bad actors in the traditional, high-cost payday loan market. To achieve this goal, NAFCU recommends the NCUA adopt PAL loans that have flexible parameters allowing credit unions to establish loans that work best for their members.

General Comments

NAFCU has long advocated for short-term, small-dollar lending options that meet the needs of credit union members. Access to safe and affordable lending options is a necessity, and given the current options available, the need for greater innovation and expansion of product availability has never been more paramount.

Historically, the marketplace for short-term, small-dollar loans has been dominated by less-regulated entities, such as traditional payday lenders and check cashers, who charge consumers unfathomable rates of interest. In fact, the average annual percentage rate (APR) for a payday loan is upwards of 400%.[1] These high-cost loans create a "snowball effect" where consumers continually renew loans and are unable to get out of debt. Despite the unfavorable characteristics of traditional payday loans, there is a persistent demand for short-term, small-dollar lending. In a recent survey, 40 percent of adults reported they would need to borrow money or sell something

[1] What is a payday loan? (2017), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/ (last visited Jul 17, 2018).

in order to cover an unexpected emergency expense of $400 dollars or more.[2] Furthermore, research shows that most consumers use payday loans to cover ordinary living expenses, such as rent or utility bills.[3] Consumers need better options than those currently available in the marketplace. When armed with a workable framework, credit unions will be able to meet their members' demands for short-term, small dollar loans, while ensuring accessibility, safety, and affordability. The Bureau of Consumer Financial Protection (Bureau) recognized the importance of needing better options and extended safe harbor protections over those payday loans adhering to NCUA's PAL I rule.

Although there is a strong demand for short-term, small-dollar products in the marketplace, credit unions have experienced minimal demand for their products due to the restrictive nature of PALs I. As of March 2018, out of the 5,530 total federally-insured credit unions, 605 claimed to offer PALs, but only 523 of them showed recent activity.[4] This equates to just 10 percent of credit unions actually making PALs. Given these low numbers of PAL participants evidences that the restrictiveness of PALs I has stifled credit unions ability to provide this loan product. With greater flexibility and the ability to serve members more efficiently, demand for PALs products will likely increase. Moreover, NAFCU members report seeing a push at the state level for increased regulation of the payday loan industry, especially when there are few options besides high-cost, traditional payday loans in the state, which creates an opportunity for credit unions to gain market share. Arming credit unions with a second PALs option would allow credit unions to lend to more members, and more quickly, safely and cheaply than traditional payday lenders. Greater competition leads to greater innovation, and will ultimately force high-cost, traditional payday lenders to improve their product offerings, leading to safer products for consumers.

Credit unions generally support a PALs II option.

Generally, NAFCU and our members support a PALs II option. A recent NAFCU semi-annual compliance survey reported that 35% of members would be interested in offering, or will offer, a PALs II option. NAFCU members that do not currently offer PALs products reported that the existing framework is too restrictive and, in some instances, an unattractive lending product for their members. NAFCU appreciates the proposal's increased flexibility, as a more workable framework may lead to more credit unions offering PALs products.

The most attractive features of PALs II include the removal of a required minimum length of membership and the ability to offer more than one loan in a six-month period. Removal of these barriers allows credit unions to assist new members almost immediately, facilitating the goal of PALs, which is providing members with immediate and emergency cash. Members place a premium on speed, thus removal of a minimum membership requirement enhances the

[2] Report on the Economic Well-Being of U.S. Households in 2017, (2018), https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf (last visited Jul 17, 2018).
[3] Payday Lending in America: Who Borrows, Where to Borrow, and Why, (2012), http://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why (last visited July 17, 2018).
[4] NCUA Call Report Data (March 2018)

attractiveness of the option. Allowing more than one loan in a six-month period is appealing because financially distressed members may need multiple loans to accommodate their financial situation and regain a strong financial foothold. When a consumer applies for a credit card, the credit card company does not tell that consumer that they are ineligible because they already have credit cards. The same principle should apply for these short-term, small-dollar loans. So long as credit unions perform the necessary and required due diligence, members should be able to take out more than one loan during the given timeframe.

Despite the new attractive features of PALs II compared to PALs I, the option may still not be a viable product for credit unions. NAFCU fears that the NCUA's goal of increasing the availability of consumer-friendly, short-term, small-dollar loans may not come to fruition. While PALs II is somewhat more flexible than PALs I, the framework is still restrictive. Further, NAFCU members have mixed feelings in regard to losing safe harbor protection from the Bureau of Consumer Financial Protection's (Bureau) payday lending rule. At this time, we recommend the NCUA explore additional PALs options that may be implemented more easily by credit unions and will better serve members, but maintain an option afforded safe harbor protection from the Bureau’s payday lending rule.

The NCUA should set flexible, simple parameters that allow credit unions to develop their own PALs option according to their respective risk profiles and member needs.

NAFCU members support a PALs option with simple parameters set forth by the NCUA that afford credit unions the flexibility to develop their own PALs product. Above all, additional options would arm credit unions with the tools necessary to assist members more effectively and safely, while continuing to balance the risks associated with short-term, small-dollar loans. Greater limitations restrict credit union participation and ultimately hurt members who may be forced to turn to traditional, high-cost payday loans. PALs I and the proposed PALs II options contain more rigid frameworks that in some cases impede consumers' access to credit, thus a high demand persists for a flexible PALs option. Credit unions will base development around their respective risk profiles and member needs. Credit unions will continue to engage in risk avoidance strategies and follow their respective underwriting standards. NAFCU suggests that this option have no minimum membership requirement, as well as the additional flexible parameters outlined below.

Parameters should set a maximum loan amount, maturity term, and an APR that is greater than those available under PALs I and II.

NAFCU members understand that credit unions are held to a statutory limitations regarding APR, pursuant to the *Federal Credit Union Act* (FCU Act). However, NAFCU believes that a higher APR will encourage credit unions to increase lending. Payday loan APR set by the Bureau and the *Military Lending Act* are slightly higher, and have been deemed by Congress and the Bureau as appropriate APRs. The NCUA should explore setting the APR on par with these rates (up to 36% APR). Setting a competitive APR will allow credit unions to increase short-term, small-dollar lending. NAFCU is not requesting an unreasonable increase in APR, the nominal increase is still far below the APR attributed to traditional, high-cost payday lenders.

The NCUA should also set reasonable parameters for higher loan amounts and maturity terms than those under PALs I and II. Due to the restrictive loan dollar amount for existing PALs products, NAFCU believes that financially distressed members will continue to seek out high-cost, traditional payday loans even after obtaining a PALs loan in order to meet financial obligations. As a result, credit unions need the ability to build a product with higher loan amounts and maturity terms, while still protecting members and ensuring the loan amount does not exceed a reasonable percentage of the members' net worth.

Parameters should allow credit unions the ability to offer open-end and closed-end loan options.

NAFCU members envision an option that allows both open-end and closed-end loans, which will enhance credit unions' flexibility and ability to cater to their membership. An open-end PALs loan would involve a revolving line of credit whereby members are approved for a certain amount, but would only incur the initial underwriting costs, therefore saving time and resources for credit unions and members alike. Having the ability to offer an open-ended option assists members who may have to turn to other high-interest, open-ended loan options for emergency cash needs such as high interest credit cards. Allowance of an open-ended loan option also assists those members who would be unable to qualify for other open-ended loan products.

Parameters should set a higher application fee, as well as set participation fees for open-end loans.

Credit unions constantly battle to strike a balance between providing a vital loan product that enables member financial stability and health with managing the associated risks of these loan products. Circumstances often result in the risks outweighing the return, and as a result, credit unions are unable to offer short-term, small-dollar loan options to their members. PALs loans are priced at below market cost and often result in losses to credit unions because credit unions are in the business of helping their members recover from financial emergencies. At their very core, credit unions were organized "for the purpose of promoting thrift among [their] members and creating a source of credit for provident or productive purposes."[5] In order for credit unions to continue to provide this important credit, the NCUA needs to reevaluate PALs fee caps.

The current rule allows credit unions to charge an application fee that reflects the actual costs associated with processing the application, but in no case may this application fee exceed $20 dollars. In some cases, NAFCU members have found that the statutory cap on application fees equals fees paid to third-party service providers. At the very least, a higher application fee cap would be necessary given the technology, personnel, and marketing costs incurred in order to process an application. These costs reflect the actual costs of processing the application. A reasonable increase to the application fee cap would still provide a low-cost option to credit union members.

For those PAL options that are open-end loans, credit unions should be able to charge participation fees, so long as the participation fees do not constitute finance charges under the *Truth in Lending Act* (Regulation Z). Members would avoid multiple application fees resulting in lower costs

[5] 12 U.S.C. § 1752(1).

overall. Given the risks involved, and the fact that credit unions are taking on these risks with little to no financial gain on their end, allowing a credit union to charge an annual participation fee further incentivizes offering the PALs.

Parameters should allow credit unions the ability to offer multiple outstanding loans at a given time.

Originally, PALs I prohibited multiple outstanding loans with the idea that a PALs loan could get members back on sound financial footing and able to utilize traditional lending products. However, it may take members some time to regain their financial footing if they are unable to repay an outstanding PALs loan but have a continued cash need. Further, prohibition on multiple outstanding loans may force the member to undertake a higher-cost loan to fulfill the cash need. Our members recommend that credit unions be given the ability to provide multiple outstanding loans at one time if they so choose, which will allow them to better serve members. Credit unions will hold themselves accountable and ensure proper underwriting. Further, credit unions will continue to participate in risk avoidance strategies ensuring that a member has the ability to take out multiple PAL loans.

Parameters should allow credit unions flexibility in verifying income.

Under the current rule, credit unions must establish practices of verifying income of member borrowers. The rule broadly provides that some established practice must be implemented and later states in the "best practices" section that looking at the balance of the member's established account along with proof of financial income constitutes sufficient underwriting standards for PALs. NAFCU recommends maintaining a broad underwriting standard for verifying a member's income. Given that this option will likely not have a minimum membership requirement; credit unions will only be able to verify income given the member's share account is just established.

The NCUA should work with the Bureau to ensure all PALs, both proposed and adopted in the future, fall within the safe harbor exemption.

Although NAFCU members are generally open to additional PAL options, concerns still remain about complying with the Bureau's payday lending rule. We understand that PALs II, as proposed, will fall within the Bureau's alternative loan exemption; however, any future PALs options are afforded no exception from the rule. Expanding the safe harbor exemption to encompass all PAL loans will assist in widespread adoption of the PALs program, and a greater number of these loans will be made. Expansion of the safe harbor exemption will give credit unions peace of mind knowing that they are in compliance with both the NCUA and the Bureau's rules. Credit unions will be more apt to begin PALs programs if they have not already done so, or to expand their PALs programs to include additional PALs options. Alternatively, NAFCU recommends that at a minimum, the safe harbor exemption should expand to encompass the PAL II option as proposed.

Conclusion

NAFCU recommends the NCUA provide a PALs program encompassing the PALs I option, preserving the safe-harbor exemption from the Bureau's payday lending rule, as well as an additional PAL options with simple and flexible parameters as suggested herein, allowing credit unions to build their own loan products. NAFCU believes that removing the restrictive boundaries of the PALs options will achieve better small-dollar, short-term loan options for members, and consequently will lead to increased volume in credit unions offerings. NAFCU appreciates the opportunity to share its members' views on this matter. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel