Comments submitted by

Center for Responsible Lending
and
Self-Help Credit Union

to the

National Credit Union Administration

RE: Payday-Alternative Loans

12 CFR Part 701
RIN 3133-AE08
77 Federal Register 59346 (September 27, 2012)

November 26, 2012

The Center for Responsible Lending (CRL) is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest nonprofit community development financial institutions, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a nonprofit loan fund. For 30 years, Self-Help has focused on creating asset-building opportunities for low-income, rural, women-headed, and minority families, primarily through financing safe, affordable home loans. In total, Self-Help has provided over $6 billion of financing to almost 70,000 low-wealth families, small businesses, and nonprofit organizations in North Carolina and across America. Self-Help also serves more than 80,000 mostly low-income families through 25 retail credit union branches.

Thank you for the opportunity to submit comments concerning the National Credit Union Administration's (NCUA) advanced notice of proposed rulemaking (ANPR) to consider amending its program designed to encourage small dollar loans ("payday-alternative loans (PALs or PAL loans)").

We thank NCUA for its efforts to protect credit union members from payday loans. In recent years, these efforts have contributed to a decrease in the number of credit unions we are aware of engaging in payday lending, either directly or indirectly through credit union service organizations (CUSOs).[1] And through its PAL program, NCUA seeks to encourage federal credit unions (FCUs) to offer small dollar installment loans that can be significantly cheaper than payday loans.

But we urge NCUA to take further action to ensure that no credit unions are engaged in payday lending in any capacity. One of the nation's largest credit unions, Kinecta, continues to make payday loans, and others engage in payday lending through CUSOs. The other federal banking regulators have not tolerated bank engagement in payday lending through third-party relationships; they essentially ended so-called "rent-a-charter" relationships a decade ago.[2] Thus, credit unions are the only financial institutions that have continued to be permitted to engage in third-party payday lending relationships. This needs to change.

With respect to the PAL program, we urge NCUA to ensure that this program does not lead credit union members into the same cycle of debt it is intended to prevent. To that end, the maximum application fee should not be increased; it should be limited to one per year; and the minimum loan term should be increased to 90 days. There are a host of alternatives to payday loans that bear no resemblance to payday loans in structure or cost; many are not loans at all. Sanctioning expensive payday loan-like products—which, depending on the loan size and repayment term, may be only mildly less dangerous to borrowers—is not necessary and risks harming the very people it aims to help.

This comment provides our thoughts on NCUA's general approach to discouraging payday loans as well as specific responses to the questions enumerated in NCUA's present ANPR.

Summary of comments:

- NCUA should consider the broad range of alternatives to payday loans, credit and non-credit, rather than expanding a similarly structured payday-like product.

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[1] The National Consumer Law Center (NCLC) reports a decrease in the number of identified credit unions engaging in payday lending from 58 in 2009 to 25 in 2011. Comments of NCLC on behalf of its low-income clients to NCUA on its proposed CUSO rule (Sept. 26, 2011) [hereinafter NCLC's 2011 Comments].

[2] OCC Advisory Letter on Payday Lending, AL 2000-10 (Nov. 27, 2000); FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005; In the early 2000s, the Federal Reserve Board stopped the First Bank of Delaware from renting its charter to storefront payday lenders. *See* consumer complaint about the bank's payday activities at Consumer Federation of America, et al, *Consumer and Community Groups Call on Federal Reserve Board to Halt Rent-A-Bank Payday Lending By Delaware Bank*, April 15, 2003, *at* http://www.consumerfed.org/financial-services/166.

- NCUA must stop credit unions from engaging in payday lending outside of the PAL program.

- NCUA must ensure the PAL program is not operating like a series of high-cost payday loans:
    - NCUA's limit of six loans annually is a critical restraint on its PAL program, but underwriting standards should still require an assessment of the borrower's ability to repay the loan without taking out a subsequent one.
    - The application fee should be limited to once per year to cover the one-time cost of qualifying a borrower for a PAL, and the maximum permissible application fee should not be increased.
    - An increase in the maximum interest rate of up to 36% is far preferable to an increase in the maximum application fee.
    - The minimum loan term should be lengthened to 90 days, and the maximum loan term should be lengthened to one year.
    - The permissible loan range should not be increased.
    - PAL loans should remain limited to one at a time per borrower.
    - The minimum membership time of one month should not be reduced.
    - PAL loans should remain limited to twenty percent of an FCU's net worth.

- NCUA should address abusive overdraft fees, which undermine the effectiveness of any program aiming to help vulnerable members.

I. NCUA should consider the broad range of alternatives to payday loans, credit and non-credit, rather than expanding a similarly structured payday-like product.

A. The structure of payday loans—their high cost combined with a short repayment period—creates a long-term cycle of debt, causing serious harm to borrowers.

As NCUA has long recognized, payday loans, though marketed as short-term debt to cover emergencies between paychecks, in fact lead to long-term cycles of repeat loans.[3] This is due to the product's fundamental structure: the high cost combined with a short repayment term results in most borrowers having no choice but to take out more loans to pay off the initial loan. Indeed, CRL's 2009 analysis of loan-level storefront data found that, of loans made to repeat borrowers, *94 percent* were opened within one month of the borrower's previous loan: a clear sign of the product's failure to meet borrowers' financial needs.[4]

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[3] *See*, *e.g*., NCUA letter to Federal Credit Unions on Payday Lending, 09-FCU-05 (July 2009), noting that borrowers can "find themselves in cycles where their loans roll over repeatedly, incurring high fees, and are unable to break free of this unhealthy dependence on payday loans."

[4] Leslie Parrish and Uriah King, *Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76 Percent of Total Volume*, Center for Responsible Lending, 7/9/09, available at: http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

Since CRL's 2010 comment letter on NCUA's initial proposal, we have further studied the impact this cycle of debt has on borrowers over time.[5] Tracking payday borrowers for two years after taking out their initial loan, our study found that borrowers were indebted an average of 212 days their first year, and that they became more heavily indebted—taking out loans more frequently and for larger amounts—over time.[6] And nearly 50 percent of payday borrowers ultimately defaulted.[7]

As NCUA has also long recognized, the payday lending debt trap has serious negative consequences for borrowers beyond defaulting on the payday loans themselves.[8] Studies have shown these consequences to include higher rates of bank account closures,[9] delinquency on other debts,[10] and even bankruptcy.[11]

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[5] Uriah King and Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt*, Center for Responsible Lending, 3/31/11, available at: http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf.

[6] *Payday Loans, Inc.* found that active borrowers (those taking out at least one loan in each six-month period of the second year) took out an average of nine loans in the first year and 12 loans (or one/month) in the second year. In addition, the data showed that the amount borrowed also increased over time. The first loans taken out by borrowers were for relatively smaller amounts (an average of $270), compared with an average loan amount over the whole two-year study of $466—a 67 percent increase. This is problematic because taking out larger loans puts borrowers at greater risk of being unable to retire their payday loan debt and as a result needing to take out a new loan each pay period.

[7] *Payday Loans, Inc.*, *supra*.

[8] *See*, *e.g*., NCUA letter to Federal Credit Unions on Payday Lending, 09-FCU-05 (July 2009), noting that the cycle of debt "exacerbates other financial difficulties payday loan borrowers are experiencing."

[9] *See*, *e.g*., Dennis Campbell, Asis Martinez Jerez, & Peter Tufano, *Bouncing out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,* Harvard Business School, 12/3/08, available at: www.bostonfed.org/economic/cprc/conferences/2008/payment-choice/papers/campbell_jerez_tufano.pdf.

[10] One study found that once credit card users began borrowing from payday lenders, they became 92 percent more likely to become delinquent on their credit card payments. Sumit Agarwal, Paige Marta Skiba, and Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?,* Federal Reserve Bank of Chicago, Vanderbilt University Law School, and University of Pennsylvania, 1/13/09, available at: http://www.nber.org/papers/w14659. In addition, a study comparing low- and middle-income households in states with and without access to payday lending found that those who could gain access to payday loans were more likely to have difficulty paying bills or to have to delay medical care, dental care, and prescription drug purchases. Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market,* Kellogg School of Management, Northwestern University, 1/3/09, available at: www.kellogg.northwestern.edu/faculty/melzer/Papers/realcosts_melzer_07.02.09.pdf.

[11] Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania, 10/10/08, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

B. Successful alternatives to payday loans must not lead to a long-term cycle of debt.

As NCUA recognizes, for a loan product to be a successful alternative to a payday loan, it must not create a long-term cycle of debt.[12] Successful alternatives to payday loans, then, must not share the high-cost, short-term structure that prevents a borrower from repaying the loan without taking out another one.

Yet the current program indeed permits high-cost, short-term loans. A $200 loan with a $20 application fee, 28% APR, and a one-month loan term is a high-cost, short-term loan. And if the loan is made repeatedly over the course of a year, the application fee operates much like the fee charged on a payday loan, being repaid each time without a real reduction in principal. Borrowers may find themselves trapped in a cycle of debt that, while less expensive than traditional payday lending, is expensive nonetheless. And without an exit strategy after the sixth loan, credit union members may be left only worse off than when they started borrowing, and more vulnerable to other high-cost loans from other sources.

C. "Alternatives" to payday loans should be conceptualized broadly.

In our 2010 comments on NCUA's original small-dollar, short-term loan proposal, we encouraged NCUA to conceptualize "alternatives" to payday loans broadly. We emphasize the same today.

As NCUA notes in its proposal, some credit unions are meeting the small-loan needs of their members with products outside of the formal PAL program.[13] Indeed, many credit unions serve these needs with a range of existing affordable products that don't share harmful structural similarities with payday loans, including overdraft lines of credit, other lines of credit, signature installment loans, and credit cards.[14] And credit unions offer non-credit options as well, like free financial counseling and savings plans to get members back on their feet.

Even outside of a borrower's credit union relationship, there is a wide range of options for consumers to bridge a budget gap without becoming trapped in payday loans. Examples of other ways to handle financial stress include payment plans with creditors; advances from employers; consumer credit counseling; saving; budgeting and doing without; borrowing from friends and family; emergency assistance programs from faith-based or community organizations; military

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[12] The Board's PAL program aims in part to address the difficulty payday borrowers have "break[ing] free" from the cycle of repeat loans. 77 Fed. Reg. 59347.

[13] "[T]he Board recognizes that some FCUs offer other non-PAL loan products and services to their members that also reduce dependence on traditional payday lenders." *Id.*

[14] Many of these examples are described in National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't*, June 2010, available at: http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

loans; and small loans from consumer finance companies. *A cycle of debt created by payday loans only pushes these safer options further out of reach*.[15]

The following underlying reality also warrants emphasis: The demand for payday loans is not nearly as great as the payday lending industry has asserted it is. Research has found that the large majority of all payday loan volume is the result of trapped borrowers being churned, effectively to repay their original payday loan.[16] Thus, most payday loan volume is not "new money" in demand; it is "old money," recycled one pay period after another, with a new fee attached each time.

II. NCUA must stop credit unions from engaging in payday lending outside of the PAL program.

A relatively small but significant number of credit unions are engaging in high-cost payday lending, either directly, or indirectly through CUSOs.[17] These include Kinecta Federal Credit Union, one of the nation's largest credit unions,[18] which for years has been making "paydaytoday" loans, due on the next payday, currently carrying a $31.95 application fee on each loan.[19] This is not acceptable, and NCUA should put an immediate stop to it.

Other credit unions are making payday loans through CUSOs, circumventing the interest rate ceiling and undermining state protections against payday loans. As discussed in more detail in our 2011 comments on NCUA's proposed CUSO rule,[20] NCUA should put a stop to this as well.

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[15] Research from the University of North Carolina supports the notion that the debt trap of payday lending creates so many long-term problems that borrowers are better off without having access to these abusive loans. The study, which reviewed the impact of North Carolina's rate cap that effectively eliminated storefront payday lending in the state, found that the absence of payday lending has had no significant impact on the availability of credit. Moreover, it has helped more households than it has harmed. Nearly nine out of ten North Carolina households characterize payday lending as a "bad thing," and this overwhelming proportion holds true for households that have experienced financial hardship or that have previously taken out a payday loan. University of North Carolina Center for Community Capital (for the North Carolina Commissioner of Banks), *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*, November 2007, available at: http://www.ccc.unc.edu/documents/NC_After_Payday.pdf.

[16] *Phantom Demand*, *supra*. The study found that 76 percent of all payday loans were generated by borrower churn. Researchers arrived at this estimate by excluding the following loan categories from the total volume of payday lending: loans made to borrowers who take out a single loan in a year, initial loans made to borrowers with more than one loan in a year, and subsequent loans made to repeat borrowers that are not opened during the same pay period in which the previous loan was repaid.

[17] This activity has been well-tracked by NCLC, most recently in NCLC's 2011 Comments.

[18] Kinecta has approximately $3.2 billion in assets, placing it among the largest in the U.S. https://www.kinecta.org/about_kinecta.aspx.

[19] http://www.nixcheckcashing.com/payday2.html.

[20] Comments of CRL to NCUA on its proposed CUSO rule (Sept. 26, 2011); *see also* NCLC Comments to NCUA (2011).

As also discussed further in our 2011 comments, high-cost payday lending by credit unions not only harms credit union members but also poses safety and soundness risk, including reputational risk and legal risk. It also, as NCUA noted in that proposed rule, poses risk to the National Credit Union Share Insurance Fund.[21]

As noted earlier, other federal banking regulators have not allowed third-party payday lending relationships to persist.[22] They have also been increasingly proactive in addressing payday lending generally. This summer, the FDIC announced an investigation of bank involvement in payday lending,[23] and the OCC recently testified before Congress that payday lending is categorically "unsafe and unsound and unfair to consumers."[24] NCUA should be more proactive as well.

III. NCUA must ensure the PAL program is not operating like a series of high-cost payday loans.

A. NCUA's limit of six loans annually is a critical restraint on its PAL program, but underwriting standards should still require an assessment of the borrower's ability to repay the loan without taking out a subsequent one.

Given the potential for the current program to lead to repeat loans, the current limit of three loans within a six-month period is a critical component of NCUA's program. But NCUA should go further by establishing underwriting standards that require FCUs to assess the borrower's ability to repay the loan without taking out a subsequent loan.

B. The application fee should be limited to once per year to cover the one-time cost of qualifying a borrower for a PAL, and the maximum permissible application fee should not be increased.

NCUA should not increase the maximum permissible application fee of $20. In our 2010 comments, we urged that, should NCUA adopt the 28% maximum APR with an application fee of up to $20, which it ultimately adopted, it should limit the number of application fees allowed. We reiterate that recommendation today.

As NCUA notes in its ANPR, an application fee may only serve to recoup the actual costs incurred by the FCU to process a PAL loan application,[25] and we appreciate NCUA's

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[21] 76 Fed. Reg. 44867.

[22] *See* note 3, *supra*.

[23] Carter Dougherty, *FDIC to look at payday lending by banks*, Star Tribune, June 1, 2012, *available at* http://www.startribune.com/business/156520475.html?refer=y.

[24] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 1, 5.

[25] 77 Fed. Reg. 59348.

commitment to continue to scrutinize these fees.[26] But we are concerned that this program feature creates incentive for the FCU to charge the maximum application fee on each loan and to make the maximum number of loans allowed.

We certainly find it reasonable for a FCU to recoup this one-time underwriting cost. Renewing a loan does not require the same level of underwriting and processing, and therefore should not require a new fee. Charging repeat fees is one of the defining practices of payday loans. Repeat fees dramatically drive up costs on members and lead to the same payday loan-like debt cycle that the program is designed to help members avoid. Thus, an application fee should not be permitted more than once a year, commensurate with the processing and underwriting required of originating the lending relationship.

Further, the amount of the maximum permissible fee should not be increased. Many credit unions offer small dollar loans with no application fee at all,[27] and again, revenue should be derived primarily from interest.

C. An increase in the maximum interest rate of up to 36% is far preferable to an increase in the maximum application fee.

In 2010, NCUA considered the current program structure—28% APR plus a maximum $20 application fee—as well as a 36% all-inclusive APR. Today, it asks whether it should couple an increase in the permissible application fee with a *decrease* in the permissible interest rate.

An application fee of up to $20 that is repeatedly charged causes more concern than the 28% interest rate because it is far more likely to create a cycle of repeat loans. Thus, we would rather the permissible interest rate be *increased* to as much as 36% and the application fees reduced, than the permissible interest rate be decreased while the application fees remain the same or increase.

D. The minimum loan term should be lengthened to 90 days, and the maximum loan term should be lengthened to one year.

Adequate time to repay the loan is essential to a borrower's ability to do so. As we noted in our 2010 comments, a one-month loan term, particularly if underwritten solely based on recurring income, is not very different from a two-week payday loan. Such short loan terms, particularly on loans with high application fees, increase the effective cost—and thus decrease the affordability—of small dollar loans substantially. The FDIC has recommended a repayment period of at least 90 days for responsible small dollar loans,[28] and NCUA should likewise require the same for any loans qualifying for this interest rate exception.

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[26] *Id.*

[27] National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't*, June 2010, available at: http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

[28] FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 (June 19, 2007).

For the same reasons, we further recommend that the maximum repayment period be extended to one year. Repayment of a $1,000 loan in only six months can pose significant challenges to cash-strapped borrowers.

E. The permissible loan range should not be increased.

The current loan range of $200-$1,000 should not be increased. Once a loan exceeds $1,000, it should be subject to the interest rate ceiling applicable to all other loans and should be underwritten as a signature loan, commensurate with safe and sound business practices.

F. PAL loans should remain limited to one at a time per borrower.

NCUA should keep the limitation of one loan at a time per borrower. NCUA can also limit any concerns about a borrower repaying off a smaller loan in order to obtain a larger one (thus triggering an additional application fee) by limiting application fees to one per year as we recommend above.

G. The minimum membership time of one month should not be reduced.

The current minimum membership time of one month seems appropriate. A shorter membership time would be concerning, particularly if NCUA substantially expands the range of PAL loans or the percentage of an FCU's net worth the loans may comprise.

H. PAL loans should remain limited to twenty percent of an FCU's net worth.

NCUA's current limit of 20% of an FCU's net worth is sufficient. PAL loans should not comprise an FCU's main business line.

IV. NCUA should address abusive overdraft fees, which undermine the effectiveness of any program aiming to help vulnerable members.

Overdraft fees strip billions of dollars annually from struggling consumers, leaving them less able to save to weather shortfalls, more vulnerable to predatory promises of "short-term" loans, and generally financially worse off.[29] Thus, any credit union program aiming to provide more vulnerable members with responsible credit options en route to better financial stability will be far less effective when paired with a high-cost overdraft program. To ensure responsible credit union products are not undermined by irresponsible overdraft programs, we strongly urge NCUA to address high-cost overdraft programs by advising the following:

[29] CRL's most recent detailed discussion of abusive high-cost overdraft programs can be found in our comments to the Consumer Financial Protection Bureau, submitted jointly with Consumer Federation of America and the NCLC (on behalf of its low-income clients), June 29, 2012, *available at*: http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/Overdraft-Comment-by-CRL-CFA-and-NCLC-Docket-No-CFPB-2012-0007.pdf.

- *No manipulation of posting order to drive up fees*. Credit unions should not drive up overdraft fees by posting transactions in order from largest to smallest, a practice that, in light of rampant litigation, clearly poses reputational and legal risks. The FDIC prohibited this practice among its supervisees in its 2010 guidance.[30]

- *No overdraft fees on debit card and ATM transactions*. Credit unions should not charge overdraft fees on debit card and ATM transactions that could easily be declined for no fee.

- *No more than six fees in a 12-month period*. After six overdraft fees in a 12-month period (the FDIC's guidance identified more than six as "excessive"), including "sustained" or "continuous" overdraft fees, a member should be provided an affordable installment loan to repay the remaining balance, and no further overdraft fees should be charged.

- *Reasonable and proportional fees.* Overdraft fees should be reasonable and proportional to the amount of the underlying transaction and to the cost to the credit union of covering the overdraft, also consistent with the FDIC's overdraft guidance and rules governing penalty fees on credit cards.

Eliminating abusive overdraft programs would go a long way toward making FCU members less vulnerable to payday loans and other predatory products.

We appreciate NCUA's consideration of our comments. If you would like to discuss them further, please contact Michael Calhoun (mike.calhoun@responsiblelending.org), Rebecca Borné (rebecca.borne@responsiblelending.org), or Randy Chambers (randy.chambers@self-help.org).

[30] Federal Deposit Insurance Corporation, Supervisory Guidance for Overdraft Protection Programs and Consumer Protection, FIL-81-2010 (Nov. 24, 2010) .