August 3, 2018

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Payday Alternative Loans, Proposed Rule, 12 CFR Part 701, RIN 3133-AE84

Dear Secretary Poliquin:

I. Introduction

The **Center for Responsible Lending (CRL)**, **Self-Help Federal Credit Union**, **Self-Help Credit Union**, and the **National Consumer Law Center (on behalf of its low income clients) (NCLC)** submit these comments in response to the National Credit Union Administration (NCUA or the Board)'s proposal to expand its payday alternative loan (PAL) program.

We thank NCUA for its efforts to protect credit union members from payday loans. In recent years, the number of federal credit unions (FCUs) we are aware of engaging in payday lending, either directly or indirectly through credit union service organizations (CUSOs), has decreased to a single FCU. And through both its regular rules and its PAL program, NCUA has encouraged FCUs to offer small dollar installment loans that can be significantly cheaper than payday loans.

At the same time, we are very concerned that PAL II as proposed, or a potential PAL III, will increase the likelihood that credit union members end up in cycles of unaffordable high-cost loans that resemble payday loan debt. Federal credit unions already offer a range of products that meet small dollar credit needs that bear no resemblance to payday loans in structure or cost. Thus, authorizing additional expensive payday loan-like products is not necessary, yet risks harming the very people it aims to help.

Most critically, we oppose removing the limit of three application fees per six months, as this could lead to the high-cost loan flipping PAL has been intended to prevent.[1] Indeed, repeat borrowing at so high a cost violates the very definition of "Federal credit union" in the Federal Credit Union Act: "a cooperative association organized . . . for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes" (emphasis added).[2] Loan flipping runs directly counter to this purpose. We believe that NCUA's intent, like FCUs, is to help members. Our experience is that repeat borrowing is essentially credit for unproductive purposes, providing little-to-no real benefit to

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[1] NCUA describes the harmful cycle of repeat payday loans in its proposal, 83 Fed. Reg. 25583. We note that the Consumer Financial Protection Bureau (CFPB or the Bureau)'s rule addressing payday loans would not permit unlimited unaffordable loan flipping, but as discussed herein, the CFPB has stated that it is reconsidering that rule, and NCUA must not rely on it to protect credit union members from predatory payday loans.

[2] 12 U.S.C. § 1752(1); accord Oiciyapi Federal Credit Union v. National Credit Union Admin., 936 F.2d 1007 (8th Cir. 1991) (affirming NCUA decision to dissolve credit union involved in payday lending).

the borrower, and often inflicting harm. Moreover, as we explain in section V.A below, the proposal to lift this limit rests on an erroneous reading of the CFPB Payday Rule, further compelling the Board not to finalize this change as proposed.

We also oppose lowering the minimum loan size, which would permit loans over 340% APR. In addition, we oppose further erosion of the federal interest rate cap by expanding the 28% cap to $2,000 loans. We support extending the maximum loan term to one year, and we do not object to lifting the term of membership requirement if the limit on the number of fees is retained. Finally, we strongly oppose proposing a PAL III program that would permit even more expensive or larger loans or weaker underwriting.

Since the Board last considered changes to the PAL program in 2012, the harms of payday lending have been more comprehensively and thoroughly documented than ever before.[3] High-cost payday lending is a debt trap by design, exploiting the financially distressed and leaving them worse off, leading to a host of financial consequences that include greater delinquency on other bills,[4] high checking account fees and closed accounts,[5] and bankruptcy.[6] The harms of the cycle of debt have long been recognized by NCUA.[7]

Since 2012, the number of states whose interest rate caps keep payday lenders out of their state has risen to 15 (plus the District of Columbia).[8] At the same time, payday lenders have been shifting to longer-term payday installment loans—still carrying triple-digit interest, still tied to repayment on payday, still made with little regard for the borrower's ability to repay the loan while meeting other expenses.[9] These loans have the potential to inflict as much or more harm—creating a deeper, longer

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[3] *See* CFPB, Rule Addressing Payday, Vehicle Title, and Certain High-Cost Installment Loans, Final Rule, 82 Fed. Reg. 54472 (Nov. 17, 2017) (CFPB Payday Rule) and Docket No. CFPB-2016-0025 associated with that rule. CRL and NCLC's comments, filed with additional consumer and civil rights groups, are available here: https://www.responsiblelending.org/research-publication/comment-cfpbs-proposed-rule-payday-and-car-title-lending (CRL, NCLC, et al., Comments on CFPB Payday Rule).

[4] *See, e.g.*, B. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, (2011), Oxford University Press, *available at* http://bit.ly/10M01tZ; Agarwal, S., Skiba, P. M., & Tobacman, J., *Payday loans and credit cards: New liquidity and credit scoring puzzles?* NBER Working Paper (2009), *available at* http://bit.ly/RtDsXx.

[5] CFPB Payday Rule, 83 Fed. Reg. 54564, 73; *see also* 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.

[6] 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.

[7] *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."

[8] South Dakota passed an interest rate cap by ballot initiative in 2016.

[9] CRL, NCLC, et al., Comments on CFPB Payday Rule at § 2.5 (pp. 31-34) and § 10.1-10.3 (pp. 165-172).

debt trap—for borrowers than two-week payday loans.[10] Research CRL released this week describes the experience of focus group participants in Colorado, where high-cost longer-term payday loans often triggered significant additional financial hardships for borrowers.[11] While payday lenders push hard at the state level to make these long-term, high-cost loans legal in more states, the large majority of state legislatures have rejected these efforts. But more prevalent high-cost installment lending remains a very real threat.

Meanwhile, although the Consumer Financial Protection Bureau (CFPB or the Bureau)'s Payday Loan Rule (the CFPB Rule) would address the worst abuses of the short-term payday lending debt trap, the Bureau's current leadership has been hostile toward that rule and has publicly stated that it plans to reconsider it. So as we evaluate the proposed PAL changes, we cannot rely on the protections of the CFPB Rule to protect credit union members from the harms of unaffordable short-term loans. And as the CFPB Rule does not establish ability-to-repay protections for longer-term payday loans, NCUA must also ensure that protections on longer-term loans are sufficient.

Against this landscape, the federal banking regulators and NCUA are considering how to regulate bank and credit union involvement in small dollar lending. How these regulators address high-cost loans, including any shift toward high-cost installment payday lending, has great significance for the high-cost lending landscape across the country, whether by depositories or non-depositories. NCUA, along with the OCC, Federal Reserve, and FDIC, set the tone for what is considered responsible—indeed "provident and productive"—lending versus what is recognized as predatory. In May of this year, CRL and NCLC, along with several other national consumer and civil rights groups, sent the federal regulators a letter urging that they ensure that bank and credit union loans—whether single-payment or installment—be reasonably priced (compliant with FCU regulation for federal credit unions, and no more than 36% for other depositories) and based on the consumer's ability-to-repay the loan, taking into account both income and expenses.[12]

Within this broader context we make the following recommendations, which we then discuss in turn:

- Encourage credit unions to continue to serve small dollar loan needs with products and services outside of the PAL program(s) that are not similar, structurally or in APR terms, to payday loans.
- Stop credit unions from engaging in payday lending outside of the PAL program(s).
- Further consider the interaction of PAL II and a potential PAL III with state laws, consistent with Executive Order 13132.

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[10] *Id.*

[11] Center for Responsible Lending, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans* (July 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf (CRL, *Sinking Feeling*).

[12] Letter from CRL, NCLC, and other national civil rights and consumer groups to federal regulators (May 4, 2018), *available at* https://www.responsiblelending.org/research-publication/bank-payday-loans-are-high-cost-debt-traps-just-payday-loans-non-banks (May 2018 Consumer/Civil Rights Groups Letter to Federal Regulators).

- Ensure that PAL programs do not operate like a series of high-cost payday loans:
  - Most critically, do not remove the limit of three application fees per six months, as this could lead to the very high-cost loan flipping PAL has been intended to prevent;
  - Do not lower the minimum loan size, which would permit extraordinarily high-cost loans of over 340% effective APR;
  - Do not raise the maximum loan size permitted to carry 28% interest to $2,000, as this unnecessarily further erodes the federal credit union interest rate cap;
  - Extend the maximum loan term to one year, which may be appropriate in some cases even for a $1,000 loan;
  - Extend the minimum loan term to 90 days;
  - Lift the minimum length of membership requirement only if the existing limit on the number of application fees is retained;
  - Require an income- and expense-based ability-to-repay determination on every loan, and monitor late payments, overdraft/non-sufficient funds fees triggered by other transactions on the account, and PAL loan defaults, for signs of inability to repay;
  - Do not incorporate features of PAL II into PAL I;
  - Continue to limit PAL loans—across all PAL programs—to one at a time per member;
  - Continue to limit PAL programs—across all PAL programs—to 20 percent of an FCU's net worth.

- Do not propose a PAL III, particularly for more expensive or larger loans or with weaker underwriting. In addition, any open-end product should be approached with great caution, strictly limiting participation fees and ensuring that minimum payments repay the credit line in a reasonable period of time.

- Address abusive overdraft fee programs, which undermine the effectiveness of any program aiming to help financially vulnerable members.

II. Encourage credit unions to continue to serve small dollar loan needs with products and services outside of the PAL program(s) that are not similar, structurally or in APR terms, to payday loans.

Loan products do not need to look and function like payday loans—and it's preferable that they not—in order to serve financially distressed individuals. Thus, it is critical that any PAL program be considered within the broader context. As the Board has long noted,[13] credit unions serve small dollar loan needs with a range of existing affordable products outside of PAL programs—small dollar loans within the current 18% interest cap, overdraft lines of credit, other lines of credit, signature installment loans, and credit cards[14]—as well as free financial counseling and savings plans. For example, 43% of Self-Help

[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." NCUA, Advanced Notice of Proposed Rulemaking, Payday Alternative Loans, 77 Fed. Reg. 59346, 47 (Sept. 27, 2012).

[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, http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

Federal Credit Union's unsecured loans and 74% of its credit card lines opened during the first half of 2018 were for $2,000 or less. These were all done outside of a PAL program.

The results of a recent Arizona survey of credit unions also illustrate this clearly. As noted in the comments on this proposal of Arizona-based Center for Economic Integrity, last year the Arizona Community Action Association surveyed credit unions and other providers to catalog small dollar loan options. They identified 41 credit unions (28 of which are federally chartered) that offered one or more loan products of $500 or less in fourteen Arizona counties. These loans cost less than 18 percent APR, do not incur fees beyond an annual credit union membership fee, if any, help build credit, have no pre-payment penalties, and do not require collateral. Of the federally-chartered credit unions, four reported PAL loans in their most recent NCUA call reports (Coconino, EM, Rim Country, and Sunwest credit unions). The ACAA survey illustrates that the vast majority of small dollar lending takes place outside the higher-cost PAL program.

Non-PAL products and services are generally lower cost than PAL loans and have the advantage over PAL of not being structured like payday loans carrying a significant upfront fee per loan (see further discussion of this issue in section III.A below). We urge NCUA to continue to encourage these types of products rather than expanding the number of application fees permitted under PAL or PAL II or proposing a PAL III.

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. A number of other sources of liquidity are becoming more prevalent to help cash strapped consumers. These include employer and non-profit employer-based emergency loan programs, loans from religious institutions, and extended payment plans from suppliers of consumer services such as utility and telecommunication companies. Reputable nonprofit credit counseling agencies can also be helpful in contacting creditors and arranging for extended payments at lower interest rates. Additionally, a growing list of local nonprofits and community centers offer emergency debt counseling and financing assistance for such items as rent, transportation, and utilities.[15]

More significantly, the demand for payday loans is not nearly as great as payday lenders assert, and the total market volume figures are more phantom than real. Research has repeatedly found that the large majority of all payday loans—the Bureau found 85%—are taken within 30 days of the borrower's previous payday loan. They are the result of trapped borrowers being flipped from one loan into another, effectively to repay their original payday loan. In other words, payday loans typically do not provide new credit or otherwise meet an emergency cash flow shortfall; rather, they generate their own demand without productively filling a credit need. This is not a space that FCUs need to fill.

III. Stop credit unions from engaging in payday lending outside of the PAL program(s).

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. In 2013, we raised concerns about several federal credit unions engaging in payday lending either directly or through third-party credit union service organizations. The Board made efforts to halt some of this activity, and not long thereafter,

[15] CRL, NCLC, et al., Comments on CFPB Payday Rule at § 19 (pp. 302 *et seq.*).

almost all of those credit unions appear to have stopped payday lending activity. We appreciate the Board's efforts here.

Today, we are aware of one federal credit union continuing to engage in payday lending. Kinecta Federal Credit Union, one of the nation's largest, has continued making payday loans through its subsidiary NIX Neighborhood Lending.[16] These loans are for up to $400, due on the next payday, currently carrying a $37.95 application fee on each loan. Together with 15% interest, the fee results in an effective annual percentage rate (APR) of 262%.[17]

Regulation Z is clear, and the Board has acknowledged, that the application fee, while it may be excluded from an APR disclosure, may not exceed the cost of processing the application.[18] The current fee of $37.95 is $6 higher than the $31.95 fee Kinecta charged from at least 2012-2016. We remain highly skeptical this fee represents only the processing cost, and not marketing costs, loan losses, collection costs and other costs, and that such cost has increased by $6. Rather, it is likely that the fee represents an evasion of the federal credit union interest rate limit.[19] This evasion exposes financially distressed consumers to severe harms caused by debt trap loans, damages the reputation of credit unions as a whole, and undermines the integrity of the regulatory landscape. NCUA should put a stop to it.

We also ask the Board to remain vigilant in preventing credit union partnerships, with CUSOs or other entities, that evade the federal credit union interest rate limit or state law.[20]

IV. Consider the interaction of PAL II and a potential PAL III with state laws, consistent with Executive Order 13132.

As the Board notes, Executive Order 13132 encourages agencies to consider the impact of their actions on state and local interests. The Board concludes that this proposal "would not have substantial direct effects on the states, on the connection between the national government and the states, or on the

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[16] https://www.nixlending.com/loan-offering/payday-loan/.

[17] The following materials, among others, note that Kinecta's application fee was $31.95 in 2012, 2013, and 2016: Comments from CRL to NCUA https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/ncua-comments_small-dollar-loans_nov-26-2012_final.pdf (2012); chart NCLC submitted to NCUA, http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Federal-Credit-Union-Payday-Loans-Chart.pdf (2013); news article, http://www.cutoday.info/THE-feature/Kinecta-Debates-Future-Of-Small-Dollar-Lending/ (2016).

[18] Regulation Z, which governs the calculation of the APR, is written by the CFPB. But NCUA can enforce Regulation Z to ensure that FCUs do not use application fees to cover items that, under Regulation Z, must be included in the finance charge, including overhead, profits, loan losses, cost of funds, customer service, collection expenses, and other expenses. Even if Regulation Z permitted disclosure of a 15% APR on a 223% loan, NCUA has separate authority under FCUA and the FTC Act to ensure the integrity of its 18% usury cap.

[19] The product also evades California state law, which does not permit payday loans, including fees, to exceed $300.

[20] For further, *see* May 2018 Consumer/Civil Rights Groups Letter to Federal Regulators.

distribution of power and responsibilities among the various levels of government."[21] Thus, the Board concludes, the proposal does not have federalism implications.

We urge the Board to reconsider this assessment, as proposed PAL II, and the potential PAL III, both have significant implications for state law. Most states regulate the interest rates permitted on small dollar loans, and non-depository lenders are all subject to those rate limits. Where very high-rate payday loans are permitted, states also regulate the size and, in some cases, the frequency of those loans.[22] Fifteen states plus the District of Columbia limit the cost of short-term loans such that payday lenders don't have active markets there, and the majority of states have caps on longer-term loans as well. Those laws reflect value judgments by legislators and voters about what the cost of credit in those states should be. Any loosening of regulations addressing high-cost payday loans by credit unions undermines and threatens state laws that don't permit the same by non-depository lenders.

V. Ensure that PAL programs do not operate like a series of high-cost payday loans.

A. Most critically, do not remove the limit of three application fees per six months, as this could lead to the very high-cost loan flipping PAL has been intended to prevent.

Since inception, PAL has permitted three loans, each with an application fee of up to $20, every six months. We have opposed permitting these six fees annually because it creates an incentive to offer shorter-term loans with a fee-per-loan model that resembles payday loans and can lead to a similar cycle of debt. If a loan is made repeatedly over the course of a year, the application fee operates much like the fee charged on a payday loan, being paid each time without a real reduction in principal. As we've noted in the past, many credit unions offer small dollar loans with no application fee at all.[23] Thus, tighter restrictions on application fees under PAL would be appropriate.

The current proposal, however, moves in the opposite direction, proposing that application fees be unlimited under PAL II because "[t]he Board believes this will better enable FCUs to meet the demands of those borrowers who take out very small loans, repay them rapidly, and need additional loans within a six-month period."[24] This rationale alarms us, as it contradicts the Board's (and other regulators') longstanding position that loan flipping should be discouraged, and it supports a proposal permitting a cycle of loans that would clearly be harmful.

Consider, for example, a one-month $200 loan with two semi-monthly payments, with a $20 application fee, at 28% interest. This loan is already permitted under PAL I and carries a very high effective APR of 180%. The new rules would permit this loan to be flipped every month for twelve months—effectively $200 of credit, flipped 12 times, at an annual cost of $240 in fees, plus 28% interest. (With the proposed

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[21] 83 Fed. Reg. 25586.

[22] For example, California limits the size of payday loans, including fees, to $300, and Washington limits payday loans to eight per year.

[23] 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.

[24] 83 Fed. Reg. 25585.

elimination of the minimum loan amount, the scenario is worse; see section B below.) With fees unlimited, credit unions could even offer a two-week loan with two weekly payments, flipping that loan an unlimited number of times and potentially doubling the fees. This is the very problem that PAL is intended to help borrowers "break free" from.[25]

Importantly, loan flipping occurs even when a loan is not technically refinanced or rolled over, and even if the subsequent loan is taken days later. The current ban on rollovers under PAL is not sufficient to prevent flipping, as a loan that is repaid and then immediately reborrowed is essentially a rollover but is not prohibited. The CFPB Rule determined that a loan taken within 30 days of a prior loan should be considered part of the same loan sequence, in part because the CFPB determined that 30 days was a reasonable representation of most consumers' expense and pay cycles.[26]

Members are already permitted under PAL I to take two additional loans within six months. Borrowers who "need" to borrow more than three times in six months are likely caught in a debt trap, where the "need" is generated by an unaffordable loan. This proposal would make PALs look significantly more like predatory payday loans, not less.

At least one market participant's response to the PAL II proposal substantiates these concerns. We reviewed a July 2018 email from CashPlea$e entitled, "NCUA Wants CUs Making Small-Dollar Loans – We Have the Answer!," touting its software product, which promises "[l]ittle to no cannibalization of NSF/OD [overdraft] income."[27] In other words, this software company does not expect these loans to help members avoid bounced payments or overdraft fees. The promise that a small loan product will not decrease overdraft and NSF fees is the same promise made by software consultants pushing unaffordable 225-300% APR "deposit advance" payday loan products made by a handful of banks until several years ago.[28] This approach is inconsistent with the notion that depository small dollar loan products should reduce members' overdraft penalties. Provident and productive credit should build members' capacity to weather shortfalls. Provident and productive credit *should* "cannibalize" overdraft and NSF revenue.

Finally, the interaction of this proposed change with the Consumer Financial Protection Bureau's payday loan rule (CFPB Rule), and the Board's presentation of the CFPB Rule in its proposal, are additional significant reasons not to lift the limit on application fees. The Board discusses its proposal to lift the limit on loan frequency in the context of its reading the CFPB Rule as treating proposed PAL II loans as,

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[25] In its proposal, NCUA describes how consumers are often unable to "break free" from the cycle of payday loans. 83 Fed. Reg. 25583. We note that the CFPB Rule would not permit unlimited unaffordable loan flipping, but as discussed herein, the CFPB has stated that it is reconsidering that rule, and NCUA must not rely on it to protect credit union members from predatory payday loans.

[26] CFPB Payday Rule, 82 Fed. Reg. 54709.

[27] https://www.cashplease.com/financial-institution-benefits/; email on file with CRL.

[28] Fiserv marketed bank payday "deposit advance" loan software and touted that bank payday lending would result in little-to-no "overdraft revenue cannibalization." Comments of CRL, NCLC, and other national civil rights and consumer groups to OCC and FDIC on their 2013 proposed guidance to address bank payday "deposit advance" loans at 20 (2013), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/bpd-comments-to-occ_fdic_may-30-2013_final-1.pdf.

under certain conditions (45 days or less, and between $200 and $1,000) as "alternative loans" under the CFPB Rule and thus exempt from that rule.[29] The Board appeared to view this "alternative loan" status as a benefit for FCUs and as further support for lifting this limit from PAL I.[30]

But, contrary to the Board's reading of it, the CFPB Rule in fact provides that loans are "alternative loans" only if they *do* retain a limit of three loans every six months.[31] Thus, if the loans exceed more than three in six months, they will be subject to the CFPB Rule – appropriately so, because these rollover loans pose the same dangers as other payday loans.

Yet the Board did not propose the other changes under consideration that would likely move PALs of 45 days or less outside the exemptions to the CFPB Rule. It proposed increasing (and decreasing) the permitted loan amount and extending the maximum term to 12 months, primarily to facilitate larger and longer-term loans that will not fall within the scope of the CFPB Rule regardless, because they should typically be longer than 45 days long. The Board seemed to appreciate that further changes that would result in PALs 45 days or less losing their exempted status from the CFPB Rule warranted further time and consideration, and it listed them as questions under consideration in the PAL III category rather than as part of proposed PAL II.

Moreover, some who read NCUA's proposal may believe, based on it, that CFPB deemed loans 45-days or less that are like the loans that would be made under the PAL II program, safer than other payday loans. In fact, however, if the loans are permitted more than three times in six months, as proposed PAL II would permit, CFPB did not deem such loans safer. This misperception could influence the number and content of the comments the Board receives.

For all of these reasons, removing the limit on the number of application fees should not be finalized as proposed.

B. Do not lower the minimum loan size, which would permit extraordinarily high-cost loans of over 340% effective APR.

The Board proposes eliminating the minimum loan size for PAL II, which it explains as better meeting the demands of some borrowers. With a $100 loan, the same loan flipping and multiplying fees described

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[29] 83 Fed. Reg. 25585 ("The Board recognizes that PALs II loans will not qualify for the safe harbor from the CFPB's Payday Loan Rule. However, in the Payday Loan Rule, the CFPB also provided a partial exemption for 'alternative loans.' The CFPB defines 'alternative loans' as those loans that meet all of the requirements of the NCUA's current PALS rule, except that lenders are not required to have a minimum membership requirement or a limit on the number of loans they can provide to any one borrower in a six-month period . . . . Specifically, to qualify as an 'alternative loan' a PALs II loan must meet all of the requirements of PALs I, except FCUs are not required to have a minimum membership requirement or a restriction on the number of loans provided to a borrower in a six-month period.").

[30] 83 Fed. Reg. 25585 ("The Board believes this proposed change will provide FCUs with additional flexibilities while retaining a partial exemption from the CFPB's Payday Loan Rule.").

[31] 12 CFR § 1041.3(e)(2): "*Borrowing history condition.* Prior to making an alternative loan under this paragraph (e), the lender must determine from its records that the loan would not result in the consumer being indebted on more than three outstanding loans made under this section from the lender within a period of 180 days."

above would result in an APR of 345%.[32] With a $50 loan, the APR would be much higher, and very little credit would be obtained even on a loan with a $20 fee. Very small loans might also carry even shorter terms, increasing the risk of loan flipping and multiple fees. The risks of harm from permitting very small loans at $20 each outweighs the benefit of offering consumers very small loans, and it's not a risk worth taking.

There is no minimum loan size under regular NCUA rules, so small loans can be made if members want them. The difference between 18% and 28% on a $100 loan, which likely has a relatively short term, is minimal, but the risk of sanctioning flipping of small loans through this proposed change to PAL is significant.

C. Do not raise the maximum loan size permitted to carry 28% interest to $2,000, as this unnecessarily further erodes the federal credit union interest rate cap.

While our greatest concern with PAL II as proposed is the unlimited number of application fees, we are also concerned about erosion of the federal credit union interest rate cap, currently 18%, by permitting loans up to $2,000 at 28%. This is a high rate for a large loan; often, interest rate caps are tiered such that the cap on larger loans is lower than the cap on smaller loans.[33] A larger, longer-term loan provides greater opportunity for revenue, so the exemption from the FCU rate cap should not be necessary, yet it threatens an already slippery slope. In addition, the proposed minimum loan term on a $2,000 is only one month, facilitating unaffordable large loans that could be flipped indefinitely with additional fees.[34]

Moreover, while we urge an ability-to-repay requirement that considers income and expenses, the current PAL I and PAL II do not explicitly require that. As loan sizes increase, the risk of less rigorous underwriting is greater. Any loan above $1,000 should clearly be underwritten as a signature loan commensurate with safe and sound lending practices.

D. Extend the maximum loan term to one year, which may be appropriate in some cases even for a $1,000 loan.

We continue to recommend that the maximum repayment period under PAL be extended to one year. Repayment of a $1,000 loan (much less a $2,000, which we oppose permitting within PAL at 28%) in only six months can pose significant challenges to cash-strapped borrowers. If a borrower is facing a cash flow crisis that requires $1,000 (or $2,000) that they cannot meet today, they almost certainly cannot pay that loan back over 3-6 months. Extending the maturity to a year helps to ensure that the borrower can more gradually adjust their personal finances to pay-off that one-time, short-term need.

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[32] PAL II loans, if repayable in 45 days or less and exceeding three fees in six months, would be covered by CFPB's final payday loan rule, which would not permit repeat loans to this degree. CFPB has stated that it is reconsidering that rule.

[33] *See* NCLC, *Installment Loans: Will States Protect Borrowers From a New Wave of Predatory Lending?* at iv (July 2015), *available at* https://www.nclc.org/images/pdf/pr-reports/report-installment-loans.pdf.

[34] *See* note 32, above.

E. Extend the minimum loan term to 90 days.

Very short loan terms (i.e., one month) particularly on loans with high application fees, increase the effective cost, and decrease the affordability, of small dollar loans substantially, while encouraging loan flipping to generate additional fees. The FDIC has recommended a repayment period of at least 90 days for responsible small dollar loans,[35] and NCUA should likewise require the same for any loans permitted to carry higher costs under PAL.

F. Lift the minimum length of membership requirement only if the existing limit on the number of application fees is retained.

We have generally supported the one-month minimum membership requirement. If the application fee limit is not retained, we strongly oppose lifting the term of minimum membership requirement. If the limit on the number of fees is retained, we do not object to lifting the minimum membership requirement. We do, however, emphasize the prudence of a meaningful ability-to-repay determination, as discussed below. For existing members, this can be streamlined since the credit union may hold the member's transaction account and/or other information that helps assess the credit risk. In the same vein, for a new member, the credit union should be required to review not only income, but also expense, information from the new member before making a loan. See section G below for more on ability-to-repay.

G. Require an income- and expense-based ability-to-repay determination on every loan.

Efforts to encourage credit unions to offer small dollar loans should not be at the expense of traditional underwriting principles. NCUA should reject the notion that institutions should engage in collateral-based lending that looks only at borrower income—and the ability to seize that income—and does not consider the borrower's ability to afford existing expenses. This is particularly critical if NCUA expands PAL II, or proposes PAL III, to include a higher number of permitted fees, larger or longer loans, or more expensive loans.

PAL's existing best practices, which the Board proposes to extend as they are to PAL II loans, address underwriting. They provide that credit unions should adhere to principles of responsible lending and indicate that FCUs should offer loan terms for which borrowers can manage repayment . At the same time, the best practice focuses on the FCU's evaluation of income—it states that FCUs should be able use a borrower's proof of recurring income as the key criterion in determining loan amount and term. It does note that for established members, FCUs should only need to review "a member's account records" and proof of income or employment—and account records should provide a member's expense activity—but it does not explicitly state that the FCU must consider a member's expenses.

Safe and sound lending has long required lending based on the borrower's ability to repay and not based on the lender's access to collateral (asset-based lending).[36] Yet making high-cost loans tied to

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

[36] For example, in 2001, the federal banking regulators issued joint guidance on subprime consumer lending products, emphasizing that banks need to base lending on determination of the borrower's ability to repay the loan, as opposed to relying on collateral, and that the failure to underwrite the loan was a safety and soundness concern: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources

repayment from the borrower's incoming deposit—thus putting the credit union first in line for repayment—without an income-and-expense based ability-to-repay determination is asset-based lending. Looking only at income does not ensure that the borrower can continue to meet their remaining obligations and expenses after loan repayment; the borrower must only have enough funds on payday.

Payment-to-income ratios cannot substitute for meaningful underwriting, particularly for the financially distressed borrowers for whom PALs are designed. Consider a family of four at the federal poverty level of $24,300 annually, $2,025 monthly. A 5% PTI standard would assume that the borrower has $101 in extra cash each month, or $1,215 annually, that they can spare toward service of high-cost debt. Yet, by definition, the poverty level is the level at which a family already has insufficient income. Even at somewhat higher income levels, it is far-fetched to categorically assume that a subprime borrower who has already demonstrated financial distress has an extra 5% of her income available to put towards a new debt, even if that debt is not high-cost. Rather, the debt is likely to compound already an unsustainable financial burden. Collateral-based income-only lending does not sufficiently account for existing challenges meeting ongoing expenses. Moreover, payday installment loans have very high defaults even when payments are limited to 5% of income or less.[37]

As NCUA considers expansion of PAL and considers applying existing PAL I underwriting guidelines to expanded PAL programs(s), the CFPB Rule is instructive. It did exempt from its prescribed ability-to-repay determination the existing NCUA PAL program, and other loans like those loans ("alternative loans" under the CFPB Rule), on the basis that NCUA PAL loans were relatively lower cost and had relatively low charge-offs compared to other loans the CFPB Rule addresses.[38] But it did not exempt from the rule any short-term loans that could be made more than three times in six months. NCUA should not either.

In addition, while the CFPB did not finalize ability-to-repay requirements for longer-term loans at the time it finalized its rule, it made clear that it "remain[ed] concerned that failing to underwrite such products may nonetheless pose substantial risk for consumers" and said it would address those loans in a future rulemaking.

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other than the collateral pledged are generally considered unsafe and unsound. Such lending practices should be criticized in the Report of Examination as imprudent. Further, examiners should refer any loans with the aforementioned characteristics to their Agency's respective consumer compliance/fair lending specialists for additional review." FIL 9-2001, Interagency Expanded Guidance for Subprime Lending Programs, January 31, 2001, available at https://www.fdic.gov/news/news/financial/2001/fil0109.html. This guidance was applicable to subprime consumer lending generally, beyond the mortgage context, and the FDIC has cited its specific relevance to payday lending. FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, available at http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

[37] For more detailed discussion of our concerns , *see* Policy Brief, Stop the Debt Trap Campaign, *Assessing Both Income and Expenses is Necessary in Test of Borrower's Ability to Afford a Consumer Loan: A limit on loan payment size of 5% of income will not prevent borrower harm* (Nov. 9, 2017), *available at* http://stopthedebttrap.org/blog/testing-borrowers-ability-afford-consumer-loan/; *see also* CRL, NCLC, et al., Comments on CFPB Payday Rule; May 2018 Letter to Federal Regulators.

[38] CFPB Payday Rule, 83 Fed. Reg. 54549.

H. Do not incorporate features of PAL II into PAL I.

The Board asks whether it should incorporate any features of PAL II into PAL I, noting that such incorporation would make the safe harbor for PAL I under the CFPB Rule unavailable. As we oppose most of the proposed features of PAL II, with the exception extending the maximum loan term to one year, we oppose incorporating them into PAL I. At the same time, as we note below, we urge applying the limit of one loan at a time and the 20% of net worth limit to PAL I and PAL II loans combined.

I. Continue to limit PAL loans—across all PAL programs—to one at a time per member.

We strongly support a limit of one PAL loan at a time per member across all PAL programs. The proposal does not appear to explicitly discuss the limit of one loan at a time as applying across PAL programs. We believe this is the Board's intent, as the proposed regulation itself, in the PAL II section, provides, "(*3*) The Federal credit union does not make more than one **PALs loan** at a time to a borrower."[39] We believe this provision applies to PAL loans across all programs, as the subsequent provision states, "(*4*) The Federal credit union must not roll-over any **PALs II loan**," specifically referencing PAL II loans.[40] However, nowhere prior in the regulation are "PALs loan" referenced.[41]

Thus, if PAL II is finalized in any form, we encourage the Board to discuss explicitly in the final rule that loans are limited to one loan at a time across PAL programs.

J. Continue to limit PAL loans—across all PAL programs—to 20 percent of an FCU's net worth.

We support the NCUA's current limit on PALs to 20% of an FCU's net worth and urge that PAL I and PAL II loans both be included within a single limit of 20% across all PAL programs. PAL loans should not comprise an FCU's main business line, and 20% is sufficient. It would violate any principle of safety and soundness to allow an FCU to have more than that share of its net worth invested in loans where it has failed to fully underwrite the loan by relying solely on income, rather than a borrower's ability to repay, the debt. A recession—which, by definition, leaves many borrowers unemployed—would rapidly exhaust such an FCU's net worth.

Again, we are not certain from the proposal that it applies the 20% limit to PAL Is and PAL II combined. The proposed regulation states: "(7) The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of PALs I and PALs II loans made under this section of a maximum of 20% of net worth …." If PAL II is finalized in any form, we urge the Board to finalize and clearly explain a requirement that all PAL programs combined not exceed 20% of an FCU's net worth.

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[39] Proposed 12 CFR 701.21(iv)(A)(3) (emphasis added).

[40] Proposed 12 CFR 701.21(iv)(A)(4) (emphasis added).

[41] In addition, where the Board states the following, it's not explicitly clear that "one loan at a time" applies across PAL programs: "Under this proposal [PAL II], FCUs would still only be permitted to make one loan at a time to any one borrower, but would be able to make additional loans to that borrower with no time restrictions provided there is only one loan outstanding at a time to that borrower." 83 Fed. Reg. 25585.

VI. Do not propose a PAL III, particularly for more expensive or larger loans or with weaker underwriting.

The Board asks whether there is demand for an expanded PAL III product and what features and loan structures could be included. We are deeply concerned about expanding high-cost lending by federal credit unions in any manner. As we discuss in the Introduction and section II above, federal credit unions have existing products that are well-designed to meet the demand for small dollar loans. An expansion of high-cost loans by federal credit unions risks burdening members with unaffordable debt while facilitating a race to the bottom by depositories and non-depositories alike, making predatory lending more, rather than less, prevalent.

The Board further notes that along with the added flexibility PAL III would provide, the product would be subject to the CFPB Rule. For short-term loans repayable in 45 days or less, the CFPB Rule, based on many years of market research and data analysis, provides a helpful barometer for determining higher risk loans versus lower risk loans. The CFPB rule exempts PAL I loans because it deemed them lower risk, and it didn't provide additional similar exemptions—despite calls to do so—for loans with different features, including some NCUA now proposes under PAL III. The features NCUA considers for PAL III generally make loans higher-risk, more capable of inflicting harm to members, and more likely to be illegal for non-depositories to make under the laws of many states. We strongly encourage NCUA to remain faithful to the statutory FCU interest rate limit and not to move in this direction.

A. Do not increase the permissible size of the application fee.

NCUA should not increase the maximum permissible application fee of $20. As discussed above, an application fee may only serve to recoup the actual costs incurred by the FCU to process a PAL loan application.[42] At the current cap of $20, the effective APRs on some PAL loans reach the triple digits or otherwise exceed what state law would permit for a non-depository. On a six-month installment loan, most states have an interest rate cap of less than 60%, with many capping rates at less than 36%. A higher application fee will drive the effective cost of the loan up significantly.

B. Do not increase the permissible interest rate for longer-term or larger loans.

We oppose increasing the permissible interest rate for longer-term or larger loans for the reasons discussed in section IV.C above. In addition, new research by CRL underscores the dangers of high-cost longer term loans. Focus group participants in Colorado, where longer-term payday loans average 129% APR, in many cases reported that unaffordable loan payments on these loans triggered significant additional financial hardships, either immediately or down the road.[43]

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[42] NCUA has long noted this limitation on application fees in the context of PAL, including at 77 Fed. Reg. 59348-49 (2012).

[43] CRL, *Sinking Feeling* (2018), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf.

C. Any open-end PAL product should be approached with great caution.

Payday lenders notoriously use open-end products—both short- and longer-term—to evade laws and regulations aimed at addressing high-cost loans. CRL and NCLC discuss these evasions at length in our comment on the CFPB Rule at § 6.3.2.1 and § 10.6.1.[44] Banks called their deposit advance payday loans open-end, even as they repaid themselves in full from the borrower's next deposit. Longer-term lenders avoid APR disclosures and use indecipherable pricing that makes it very difficult to determine the loan's true cost. Thus, any open-end product permitted under PAL should have clearly defined limits on cost.

First, the only fee permitted on an open-end product should be a single annual application or participation fee, which should not exceed the existing PAL fee cap, with the costs otherwise reflected in a periodic rate of interest. A line of credit is underwritten at the outset up to the credit limit, so there should be no additional fees permitted to be excluded from the APR.

In addition, just as PAL loans have a maximum loan term, an open-end product must have minimum payments that ensure repayment in a reasonable period of time that approximates the terms on closed-end loans. Credit cards or other open-end credit lines that can take 5, 10 or 20 years to repay should not be permitted to charge higher interest than permitted under regular NCUA rules. At the same time, open-end credit lines must also be structured to permit amortizing payments and not be a disguised series of balloon payment loans, as bank deposit advance payday loans were.

D. Specific questions addressed.

Below are the specific questions NCUA has posed with respect to a potential PAL III:

1. *Should the Board propose a third alternative PALs rule and why?* No; see preceding portions of section VI above.

2. *Should the Board set the permissible interest rate for PALs III loans above that permitted for other PALs loans? If so, why and what legal justification supports a higher interest rate?* No; see section B above.

3. *Should the Board increase in PALs III the maximum amount an FCU can charge for an application fee above that permitted for other PALs loans?* No, see section A above.

4. *Should the Board allow FCUs to make more than one kind of PALs loan at a time to a borrower?* No; see section IV.I above.

5. *Should the Board set in PALs III the limit on the aggregate dollar amount of loans made above that permitted for other PALs loans?* No; see section B above.

6. *Should the Board eliminate for PALs III the requirement that FCUs implement appropriate underwriting guidelines?* No; see section IV.G above.

7. *Should the Board set for PALs III the maximum loan amount above that permitted for other PALs loans?* No; see section B above.

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[44] CRL, NCLC, et al., Comments on CFPB Payday Rule, at § 6.3.2.1 at (p. 95) and § 10.6.1 (p. 179).

8. *Should the maturities for PALs III loans be longer than those permitted for other PALs loans?* No; see section B above.

9. *Should the Board permit PALs III to include an open-end loan product?* Only with great caution; see section C above.

    a. *If the Board permits an open-end product, should the Board allow FCUs to charge participation fees, provided the fees are not considered a finance charge under Regulation Z?* Only if a single annual participation fee is the only fee and meets the existing $20 fee limit; see section C above.

    b. *If the Board permits participation fees on an open-end PALs product, should the Board set a maximum cap on that fee, and, if so, what should the maximum amount be?* Yes, no greater than the existing fee cap; see section C above.

10. *Should the Board require FCUs to conduct an ability to repay determination in PALs III similar to that required by the CFPB's Payday Loan Rule?* Yes; see section IV.G above.

11. *Should the Board prohibit FCUs from charging overdraft fees for PALs loan payments drawn against a member's account?* Yes, for any PAL loans; see section VII below.

VII. Address abusive overdraft fee programs, which undermine the effectiveness of any program aiming to help financially 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.[45] 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, NCUA should advise that no overdraft fees be charged on debit card and ATM transactions; that fees be reasonable and proportional to the credit union's cost; that fees be limited in number to one per month and six per year; and that credit unions not use posting orders that drive up overdraft fees.[46] These changes would go a long way toward making FCU members less vulnerable to payday loans and other predatory products.

VIII. Conclusion

We appreciate your consideration of our comments and would be happy to discuss them further.

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[45] *See* Center for Responsible Lending, *Broken Banking: How Overdraft Fees Harm Consumers and Discourage Responsible Banking Products* (May 24, 2016), *available at* https://www.responsiblelending.org/media/broken-banking-overdraft-penalties-harm-consumers-discourage-responsible-products.

[46] The FDIC's 2010 overdraft guidance and follow-up FAQs advise reasonable and proportional fees, no more than six in one year, and no posting of transactions in order from highest to lowest. Federal Deposit Insurance Corporation, Supervisory Guidance for Overdraft Protection Programs and Consumer Protection, FIL-81-2010 (Nov. 24, 2010).

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