COMMENTS to the
National Credit Union Administration (NCUA)

Regarding the
Proposed Rule on
Credit Union Service Organizations

12 CFR Parts 712 and 741
76 Fed. Reg. 44866 (2011)

by

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I. Introduction

Thank you for the opportunity to comment on NCUA's proposed rule on Credit Union Service Organizations (CUSO). The Center for Responsible Lending (CRL) is a not-for-profit, non-partisan 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, 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 non-profit loan fund. SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded SHFCU to expand Self-Help's mission. CRL has consulted with Self-Help's credit unions in formulating these recommendations.

We support greater scrutiny of CUSO activities and, in particular, urge NCUA to take action to rein in abusive payday lending by CUSOs, as well as credit unions themselves. We applaud NCUA for proposing to take a closer look at products and practices that have negatively impacted credit union members and put the credit union movement at risk. Increased oversight of CUSOs, including through data collection and enforcement action, can strengthen credit unions generally, promote wealth-building and protect credit unions' membership from abusive loans.

CUSOs assist credit unions in their mission by providing specialized expertise and services that are difficult to develop within a small credit union. However, CUSO regulations are not intended to allow credit unions to evade lending limits in the law or to distance themselves from abusive products through an indirect relationship. Indeed, that is why NCUA's CUSO regulations permit investment in CUSOs only for particular types of activities.

NCUA has in the past rightly taken the position that payday loans are inconsistent with the credit union charter as they are not "credit for provident or productive purposes."[1] It has already taken steps to safeguard credit union members from the destructive impact of payday loans. In 2009 NCUA issued strong statements about the risks of payday lending.[2] Actions by NCUA in the past resulted in several credit unions exiting the payday loan business.[3]

In 2010 NCUA issued small loan guidelines ("short-term, small amount loans" guidelines (STS) that permit a higher interest rate, 28%, for short-term loans that do not create a destructive cycle of debt in an effort to ensure that credit unions offer products that provide actual benefits to members.[4] These guidelines have been in effect for eleven months.[5] As we commented last July, credit unions have created innovative small loan products that served members and remained below the 18% annual interest rate cap.[6] NCUA stated that the new regulations would foster additional loan products that would provide a lower cost alternative to abusive payday loans.[7]

However, current NCUA action and CUSO limitations have not been sufficient to date to curb abusive payday loan activity within the credit union market. A small number of

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[1] *Oiciyapi Federal Credit Union v. National Credit Union Admin.*, 936 F.2d 1007 (8th Cir. 1991) (quoting 12 U.S.C. §1752(1)).

[2] NCUA letter to Federal Credit Unions on Payday Lending, 09-FCU-05 (July 2009).

[3] *See* Comments filed by the National Consumer Law Center (NCLC) for more detail.

[4] NCUA, Short-Term, Small Amount Loans, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

[5] For federal credit unions, the NCUA "short-term small amount loan" guidelines require a minimum 31-day term and limit the loans to three per six months (on a rolling basis). These small amount loans can range from $200 to $1,000. And credit unions are permitted to make small consumer loans under the 18% federal usury cap as well. 12 CFR § 701.21(c)(7)(iii) (1) & (2) (effective Oct. 25, 2010).

[6] *See "*Comments of the Center for Responsible Lending on the Notice of Proposed Rulemaking on Short-term, Small Amount Loans," (July 6, 2010) *available at* http://www.ncua.gov/Resources/RegulationsOpinionsLaws/Comments/701ShortTermSmallAmtLns/7-7-10-JenniferJohnson.pdf .

[7] *See* NCUA, Short-Term, Small Amount Loans, Final Rule, Sept. 2010, 12 CFR § 701.21(c)(7)(iii). Accompanying commentary *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf. The guidelines attempt to limit such loans to 3 per 6 months on a rolling basis. The guidelines would be more helpful to members if the minimum loan term were increased to allow members sufficient time to save reserves to minimize the risk of needing to immediately take out a new small dollar loan to reach the next payday. We find the argument that credit union loans need to have one month terms to prevent borrowers from supplementing the loan with a non-credit union payday loan unpersuasive – if the credit union provides an affordable loan with an affordable term, that should be a preferable alternative to the rates of a storefront payday loan.

credit unions are still offering dangerous triple-digit, short-term, balloon payment payday loans, both directly and indirectly through CUSOs.[8] We have identified 14 federal credit unions (FCUs) that are still engaged in payday lending through CUSOs and at least one making payday loans directly.[9] In addition, we are aware of 11 federally-insured state-chartered credit unions (FISCUs) engaged in payday lending through three CUSOs and at least 3 who appear to be lending directly. These numbers are undoubtedly incomplete.[10]

The NCUA should enforce the 18% usury cap (and for loans made under the, 28%[11]) for FCUs when taking all fees into account (*e.g.* application and participation fees) should be prohibited. We support applying these standards to any credit union loan, whether it is made by a FCU, a FISCU or a CUSO. The urgency for action is greatest for FCUs; NCUA should not tolerate a FCU that, through a CUSO or directly manipulating APR, offers a triple-digit loan that would be illegal to make directly because it far exceeds credit union usury limits. FISCUs that engage in dangerous lending practices such as payday lending also pose a risk to the insurance fund and warrant NCUA action.

While the NCUA has recognized the abusive features of payday lending, it has not adequately prevented federal credit unions from partnering with and profiting from relationships with CUSOs that make payday loans.[12] Further, NCUA has not expressly prohibited renting the good name of federal credit unions to CUSOs that charge triple-digit APRs to borrowers. Such action would be consistent with other federal regulators. The Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve Board (FRB) have all prohibited the "rent-a-charter" model of partnering with payday lenders.[13] All three federal regulators

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[8] *See* "Credit unions increasingly offer high-rate payday loans," Washington Post (May 30, 2011), *available at* http://www.washingtonpost.com/politics/credit-unions-increasingly-offer-high-rate-payday-loans/2011/05/25/AGg7zhCH_story.html.

[9] We are not including credit unions that offer short term loans at reasonable rates with no more than a single annual fee that does not rollover or multiply; these credit unions meet the requirements of the short-term, small amount loans" guidelines.

[10] We discuss examples of credit union activities in Section III. For additional detail please see the Comments of NCLC.

[11] Short-Term, Small Amount Loans, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

[12] *See*, e.g., *NCUA* letter to Federal Credit Unions on Payday Lending, 09-FCU-05 (July 2009); *see also* NCUA, Short-Term, Small Amount Loans, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf (, underscoring the abusive nature of payday loans, establishing guidelines for short term, small amount loans and limiting them to 3 per 6 months on a rolling basis).

[13] See discussion in Section III *infra* and accompanying footnotes 33-35 for more information concerning the prohibition of rent-a-charter.

recognized the risk to safety and soundness and the reputational risk of associating with payday lenders.[14]

Our key recommendations are:

- ***NCUA should protect the share insurance fund by immediately stopping direct credit union payday lending that violate the STS guidelines by FCUs, as well by FISCUs to protect their safety and soundness.***

- ***NCUA should prohibit all credit unions from engaging in rent-a-charter relationships with CUSOs to facilitate payday lending, whether the financial relationships are characterized as finder's fees, revenues garnered from the selling of/participation in payday loans, or direct (or indirect) investment in or funding of payday operations.***

- ***We support NCUA's proposal to examine CUSOs that engage in risk-taking, such as payday lending. Because such activities could create a safety and soundness risk to the share insurance fund, NCUA should apply the CUSO regulations regarding accounting, financial statements, access to books and reports and maintenance of separate identities any risk-taking CUSO, including those controlled by FISCUs. It should also apply FCU investment rules to FISCUs to ensure that the CUSO regulations are effective and further ensure credit union safety and soundness.***

In this comment we will address the following: Section II demonstrates that payday loans, made by storefronts or credit unions, cause serious financial harm; Section III provides evidence that credit unions are involved in payday lending; Section IV shows that payday lending poses untenable risks to credit unions, CUSOS, and their members; Section V argues that NCUA should stop credit union payday lending; and Section VI states that NCUA should collect more data regarding payday loans.

II. Payday loans, made by storefronts or credit unions, cause serious financial harm.

Payday loans have several key characteristics that create a high cost debt trap: required lump sum repayment on the next deposit; triple-digit interest rates and fees; lending based on an asset (the bank account) rather than an underwritten ability to repay; and automatic debit of bank accounts, even those that include exempt funds. Research has shown that payday lending often leads to negative financial outcomes for borrowers;

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[14] For a discussion of some of the legal concerns regarding payday lending, including payday lending by depository institutions, see joint comments of Center for Responsible Lending, Consumer Federation of America and the National Consumer Law Center to the Office of the Comptroller of the Currency (June 8, 2011) at 52-60, *available at* http://www.responsiblelending.org/overdraft-loans/policy-legislation/regulators/OCC-Comments-Payday-and-Overdraft-Guidance-Aug-8-2011_Final.pdf .

these include difficulty paying other bills, difficulty staying in their home or apartment, trouble obtaining health care, increased risk of credit card default, loss of checking accounts, and bankruptcy.[15]

Evidence suggests that low-income borrowers and people of color are more likely to be harmed by payday loans. Research shows that payday lenders target communities of color when locating their stores.[16] CRL's recent research report on payday lending done directly by banks found that nearly one-quarter of all bank payday borrowers are Social Security recipients, who are 2.6 times as likely to have used a bank payday loan as bank customers as a whole.[17] On average, the bank seized 33 percent of the recipient's next Social Security check to repay the loan.[18]

Credit union payday loans are structured just like loans from payday shops or banks. Like a typical payday loan, borrowers routinely find themselves unable to repay the loan in full and the fee *plus* meet their monthly expenses without taking out another payday loan. Recent CRL research found that the typical non-bank payday borrower takes out nine loans per year; that borrowers take out loans for more and more over time as they are driven deeper into debt; and that nearly half of borrowers (44 percent)—after years of

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[15] *See* the following studies for discussions of these negative consequences of payday lending: Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), *available at* www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; Sumit Agarwal, Paige Skiba, and Jeremy Tobacman. *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), *available at* http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf; Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873; Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, University of Chicago Business School (November 15, 2007), *available at* http://insight.kellogg.northwestern.edu/index.php/Kellogg/article/the_real_costs_of_credit_access; and Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans" (April 1, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

[16] In California, payday lenders are 2.4 times more concentrated in communities of color, even after controlling for income and a variety of other factors. State surveys have found that African Americans comprise a far larger percentage of the payday borrower population than they do the population as a whole. Wei Li, Leslie Parrish, Keith Ernst and Delvin Davis, *Predatory Profiling The Role of Race and Ethnicity in the Location of Payday Lenders in California*, Center for Responsible Lending (March 26, 2009), *available at* http://www.responsiblelending.org/california/ca-payday/research-analysis/predatory-profiling.pdf.

[17] "Big Bank Payday Loans" at 7. With respect to proportion of all borrowers who are Social Security recipients, the 95 percent confidence interval is 14 percent to 36 percent. The difference in likelihood to take a bank payday loan for Social Security recipients was statistically significant at the p<5 percent level.

[18] *Id.* The 95 percent confidence interval is 26 percent to 40 percent.

cyclic debt—ultimately default.[19] Previous CRL research has found that the typical borrower will pay back $793 in principal, fees, and interest for the original $325 borrowed.[20] Calling these loans "short-term," then, is a misnomer; they engender long-term indebtedness at a very high cost.

CRL recently analyzed bank payday loans to determine how their use compares with non-bank payday loans.[21] For the analysis, we used a database composed of real bank customers' actual checking account activity. We found that:

- Bank payday loans are very expensive, typically carrying an annual percentage rate (APR) of 365 percent based on the typical loan term of ten days;[22] and

- Short-term bank payday loans often lead to a cycle of long-term indebtedness; on average, bank payday borrowers are in debt for 175 days per year.[23]

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[19] CRL's recent analysis of Oklahoma data showed that payday borrowers were loaned greater amounts over time (i.e., an initial loan of $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half of borrowers (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011) [hereinafter *Payday Loans, Inc.*], *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

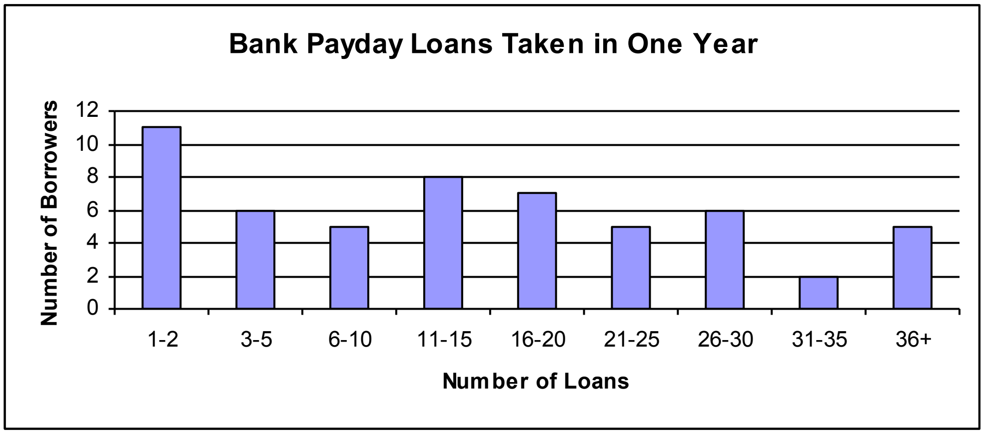
[20] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year* at 6, Center for Responsible Lending (Nov. 30, 2006), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf.

[21] For a complete discussion of this research, *see* Center for Responsible Lending, "Big Bank Payday Loans," CRL Research Brief, July 2011 [hereinafter "Big Bank Payday Loans"], *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf. For the analysis, CRL used checking account data from a nationwide sample of U.S. credit card holders, generally representative across geography, household income, and credit scores, tracked by Lightspeed Research Inc. Participating account holders provide Lightspeed access to all of their checking account activity occurring during their period of participation, including the deposits, paper checks, electronic bill payments, debit card purchases, fees, and miscellaneous charges or credits that are posted to the account. The analysis included transaction-level data for 614 checking accounts, over a 12-month period; this was the total number of checking accounts in the consumer panel held at banks that were found to offer payday loans, based on observing instances of payday loans in the accounts. We identified instances of bank payday loan repayments within 55 of those 614 accounts, and analyzed these for loan term, loan frequency, repayments, and other relevant factors.

[22] This APR is based on a fee of $10 per $100 borrowed, which most banks making payday loans charge. One bank charges $7.50 per $100 borrowed.

[23] "Big Bank Payday Loans" at 5. The analysis found that, on average, bank payday borrowers have 16 loans and, assuming these loans were not concurrent, stay in payday debt for 175 days per year. The average loan duration for all panelists was 10.7 days.

CRL's analysis of 55 consumers with bank payday loans showed that many borrowers took out ten, 20, or even 30 or more bank payday loans in a year:



The table below illustrates the reason for these repeat loans. A borrower earning $35,000 a year would be hard-pressed to pay back a $200 bank payday loan and a $20 fee as a balloon repayment in just one pay period. The bank would, of course, repay itself, but the borrower will be left with insufficient funds to make it to the end of the next pay period without having to take out another payday loan:

Cost of a Two-week, $200 Bank Payday Loan

Income and Taxes	
Income per two-week pay period	$1,342.47
Federal, state and local taxes	($11.16)
Social Security tax (at 4.2% rate)	($56.38)
Income after tax	**$1,274.93**
Payday loan payment due on $200 loan[24]	($220.00)
Paycheck remaining after paying back payday loan	**$1,054.93**
Household Expenditures per two-week pay period	
Food	$181.69
Housing	$498.09
Utilities	$126.15
Transportation	$242.07
Healthcare	$102.95
Total essential expenditures	**$1,150.95**
Money from paycheck remaining (deficit)	**($96.02)**

[24] Based on banks' typical cost of $10 per $100.

Source: 2009 Consumer Expenditure Survey, households earning $30,000-$39,999. This example is of a borrower earning $35,000 per year and excludes other costs such as childcare and clothing.

The bank or credit union's direct access to the customer's checking account exacerbates this debt trap, jeopardizing income needed for necessities and undercutting laws protecting Social Security, disability income, unemployment compensation, and other exempt funds.[25] Borrowers have no choice about the amount or timing of the repayment; they lack the ability to prioritize rent or their children's shoes or their parents' medicine above repayment of this debt to the bank.

Loans from payday shops have been found to increase the odds that households will repeatedly overdraft and eventually lose their checking accounts.[26] There is no reason to believe that payday lending by banks or credit unions would not have the same effect.

As we discuss above, high-cost loans like payday erode the assets of credit union members and, rather than promoting savings, make checking accounts unsafe for many customers. They lead to uncollected debt, account closures, and greater numbers of unbanked Americans—all outcomes inconsistent with the safety and soundness of financial institutions and the broader community mission of federal credit unions.

There is no reason to believe that the impact of credit union payday loans is any different than what CRL has found at storefronts or banks. By making these loans, credit unions leave their customers financially worse off, and potentially harm legitimate lenders and other legitimate businesses by putting themselves first in line for payment of debt. The reputation risks these products pose further undermine credit unions' safety and soundness. Despite these harms, current payday loans made through CUSOs are not directly subject to even the modest limitations in the NCUA regulations. To make matters worse, state credit unions and subsidiaries are not always subject to the rate, fee and term limitations of state consumer credit laws.

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[25] A significant number of payday borrowers are public benefits recipients, and CRL's recent research found that nearly one-quarter of all bank payday loan borrowers are Social Security recipients. (*See* Section E for further discussion.) It is likely that many bank payday borrowers also receive public benefits through unemployment compensation, disability income, Temporary Assistance to Needy Families, and other sources. That proportion will only increase with new rules eliminating paper checks for federal benefits payments and requiring direct deposit or use of a prepaid card.

[26] In North Carolina, payday borrowers paid over $2 million in NSF fees to payday lenders in addition to the fees assessed by their banks in the last year their practice was legal. 2000 Annual Report of the North Carolina Commissioner of Banks." Moreover, a Harvard study found an increase in the number of payday lending locations in a particular county is associated with an 11 percent increase of involuntary bank account closures, even after accounting for county per capita income, poverty rate, educational attainment, and a host of other variables. Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*. June 6, 2008, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873. *See also* "Payday Loans Put Families in the Red."

III. Credit unions are involved in payday lending.

NCUA promotes credit unions as "unique financial institutions" that "serve many people left unserved by traditional banking institutions and provide an alternative to the oppressive loan rates charged by predatory lenders," and "offer members a safe place to save and borrow at reasonable rates."[27] Unfortunately, some credit unions are marketing and directly making payday loans at usurious rates.[28]

Federal credit unions are currently involved in the funding and procuring of payday loans, either directly or indirectly, often through credit union service organizations (CUSOs). Federal and state credit unions that are engaging in triple-digit lending despite usury caps do so primarily in one of two ways (or both). First, they directly make payday loans, by misapplying fees or manipulating the annual percentage rate (APR) by putting the bulk of their charges into application or participation fees that they claim are excluded from the finance charge (used to calculate the APR under Truth in Lending Act (TILA) regulations). Second, some credit unions rent out their charters, facilitating payday lending indirectly and by taking a finder's or broker's fee. In the latter case, the loans are made by a CUSO because they would be illegal for the credit union to make directly.

1. Direct payday lending.

In 2009 and 2010, the National Consumer Law Center noted that several federal credit unions were offering short-term loans that have an APR far above 18%.[29] One of these, Kinecta Federal Credit Union, offered payday loans through locations within its Nix Check Cashing subsidiary. As of September 2011, Kinecta and its subsidiary still advertise their triple digit APR *Paydaytoday Cash Advance* loan product: "Kinecta Federal Credit Union offers payday cash advance at its Nix Check Cashing locations. The paydaytoday® product is provided by Kinecta Federal Credit Union available at Nix Check Cashing locations."[30] Kinecta is the lender, charging a $39.95 application fee, on top of 15% annual interest, for each of its standard $400 14-day loans. The application fee is charged per loan, even for repeat borrowers and rollover loans. With fees included,

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[27] "Facts About Federal Credit Unions," NCUA (October, 2010), *available at* http://www.ncua.gov/NewsPublications/Publications/PDF/brochures/FCUFacts/FactFedCreditUnion_A2.pdf

[28] *See* "Credit unions increasingly offer high-rate payday loans," Washington Post (May 30, 2011), *available at* http://www.washingtonpost.com/politics/credit-unions-increasingly-offer-high-rate-payday-loans/2011/05/25/AGg7zhCH_story.html (Discussing current credit union payday activities and described as "a moral lapse of credit unions.") ; *See also* "Big Banks are Entering Payday Loan Fray," Las Vegas Review Journal (Sept. 11, 2011), *available at* http://www.lvrj.com/business/big-banks-entering-payday-loan-fray-129608578.html (describing bank and credit union payday lending in Nevada and other states). The CEO of Nevada Federal Credit Union said that the credit union "got out of the payday business a couple of years ago because the 'risks were a bit too steep.'"

[29] *See* NCLC, *Stopping the Payday Loan Trap:* at 27.

[30] *See* http://www.nixcheckcashing.com/payday.aspx (last visited Sept.21, 2011).

the true cost of the loan is an APR of 362%. Clearly, the credit union is collecting most of its profit through the $39.95 "application" fee, not the $2.30 interest generated over 14 days.[31]

We are also aware of at least three FISCUs that appear to be making payday loans directly to their members.[32]

2. **Renting out credit union charters: facilitating payday lending through CUSOs .**

Some credit unions have been facilitating payday lending through their relationships with certain CUSOs. Whether the financial relationships are characterized as finder's fees, revenues garnered from the selling of or participation in payday loans, or direct (or indirect) investment in or funding of payday operations, these credit unions are engaging in rent-a-charter relationships with CUSOs to facilitate payday loans made by a CUSO that would be illegal for the credit union to make directly.

Rent-a-charter has been widely criticized by state and federal regulators, and has been strongly discouraged and eliminated by the OCC,[33] the Federal Reserve, the Office of Thrift Supervision, and, more recently, the FDIC.[34] In March of 2005, the FDIC issued

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[31] Nevada Federal Credit Union was engaged in similar manipulations, putting the entire cost of its loans into an "application" fee and charging no interest, until apparently stopped by regulators.

[32] FISCU Washington State Employees CU has a CUSO that has offered a Payday Loan Alternative at $12 per hundred (This loan product used to have a 30 day repayment term, now the repayment term is 60 days and the amount due can be satisfied in payments or in one lump sum.), *See* http://www.fuzeqna.com/wsecu/consumer/kbdetail.asp?kbid=2830&keyword=Q%2DCash&image1.x=7&image1.y=11; FISCU Mazuma Credit Union still offers a payday loan through Xtracashllc.com. Xtracashllc.com does not list the credit unions it partners with, but in the most recent press release they report that they serve 23 branches in Kansas, Missouri, and Florida ("XtraCash, LLC, Payday loan alternative CUSO XtraCash saves CUs and members $2.8 Million," (March 3, 2011), http://www.xtracashllc.com/PDF/XtraCash_CUSO saves $2.8_million_in_2010.pdf, last visited September 16, 2011). The site also lists the rates offered in each state--all the rates are still in the triple digits; FISCU Marion and Polk Schools CU makes payday loans via http://www.cuonpayday.com/maps/ The website has the MAPS CU logo as well as the CU on Payday logo. Notably, the website has exact same design as myinstacash.com.

[33] In 2002, then Comptroller of the Currency John Hawke described this practice by national banks as "an abuse of the national charter." Remarks of John D. Hawke, Jr., Comptroller of the Currency, Before the Women in Housing and Finance, Washington, D.C., Feb. 12, 2002. http://www.occ.gov/ftp/release/2002-10a.doc at 10. *See also* "OCC Takes Action Against ACE Cash Express, Inc. and Goleta National Bank," *available at http://www.occ.gov/static/news-issuances/news-releases/2002/nr-occ-2002-85.pdf*

[34]The FDIC sent a strong warning that it "believes that providing high-cost, short-term credit on a recurring basis to customers with longterm credit needs is not responsible lending; increases institutions' credit, legal, reputational, and compliance risks; and can create a serious financial hardship for the customer." *See* Payday Lending Programs, Revised Examination Guidance, FDIC Financial Institution Letters, FIL-14-2005 at 3 (Mar. 1, 2005) *available at* http://www.fdic.gov/news/news /financial/2005/fil1405a.html

The Office of the Comptroller of the Currency, which regulates national banks, the Office of Thrift Supervision, which regulates federal thrifts, and the Federal Reserve Board, which regulates member state-new guidelines regarding payday lending for the banks they regulate. The FDIC guidelines prevented banks from participating in payday lender practices that convert short-term loans into very high-cost long-term debt.[35] The guidelines enforced limits of six payday loans per year per borrower, after which the bank could no longer put the borrower into another high-cost, short-term loan. FDIC guidance prompted FDIC-regulated banks to end their partnerships with payday lenders.

As described above, the financial relationships between credit unions and CUSOs making payday loans can be characterized in a variety of ways. However, the common thread in these various relationships is that the credit union is lending its name (and the accompanying legitimacy) to the payday lending operation.

A) Finder's fee relationships with CUSOs

Several federal credit unions make triple-digit loans available to their members but do not make the loans directly. Instead, they apparently take a broker's or finder's fee on payday loans made by third-party CUSOs.[36] Sometimes these loans are offered on the credit union's website with a link to the CUSO site. In all cases, the FCU's name is associated with the loan. FCUs are, in effect, receiving a fee for referring a loan to a CUSO that the FCU could not make directly.

Mountain America Financial Services, LLC is listed in the NCUA database as a Federal CUSO of the federal credit union Mountain America. The CUSO is prominently

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chartered banks, have all disallowed the practice for the banks they supervise. *See* Uriah King, et al, "*Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina,"* *(*March 22, 2005), at 4-6 for additional information on the federal regulators' response to the rent-a-bank model.

The OCC inspected the four national banks that were partnering with storefront payday lenders and brought enforcement actions in each case to terminate those partnerships. No national banks have entered the "rent-a-bank" payday loan sector since. *See* OCC Advisory Letter AL 2000-10, Payday Lending (Nov. 27, 2000); OCC Letter to CEOs re Third-Party Relationships Risk Management Principles, OCC 2001-47 (Nov. 1, 2001)*;* OCC, Annual Report, Fiscal Year 2003, p. 17. *See also*, Jean Ann Fox, "Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury," Consumer Federation of America, (March 30, 2004) at 17.

[35] *See FDIC, Payday Lending Programs Revised Examination Guidance (2005), available at* http://www.fdic.gov/news/news/financial/2005/fil1405.pdf. ; *see also Center for Responsible Lending, "*Analysis of FDIC's Revised Examination Guidance for Payday Lending Programs" (March 14, 2005), available *at* http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/pa-FDIC_Revised_Payday_Guidelines-0305.pdf

[36] In the non-depository sector, credit service organizations (CSOs) have been used to shield payday companies from applicable lending laws and similar "finder's fees." The Texas market is one example of payday lenders avoiding the payday loan laws and operating under the CSO statute so that they can charge higher triple digit APRs on loans. For discussion of this parallel third party structure *see*, e.g., Diane Standaert and Sara Weed, "Payday Lenders Pose As Brokers to Evade Interest Rate Caps," Center for Responsible Lending (July 2010), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/states/CRL-CSO-Issue-Brief-FINAL.pdf.

displayed on the website http://myinstacash.com where payday loans are offered. While the precise relationship is difficult to identify with certainty, what is clear is that a federal credit union, through its subsidiary, is being used to market payday loans to its members.

It may be that the FCU has lent its charter to a payday business. Or the FCU (either directly or through its CUSO) could be improperly investing in a payday business. It is unclear whether the Federal entities are receiving any finder's fees for each payday loan.

In addition to the current example of FCU payday loan activities in Utah (which provides online lending as well),[37] we are aware of at least two state CUSOs that are offering payday loans for at least 11 FCUs and 4 FISCUs.[38] Another example is the Orlando Federal Credit Union. This FCU advertises its payday loan partnership with the CUSO of a FISCU: "OFCU and XtraCash, LLC are partnering to offer members a better choice to a typical Payday loan - XtraCash! XtraCash, LLC is a premier provider of practical Payday lending services for credit unions nationwide."[39] This FISCU CUSO may have relationships with both FCUs and FISCUs in three different states.[40]

CU on Payday, another CUSO, offers payday loans to members of both federal and state credit unions on terms that vary by state. For most of the federal credit unions that participate, the fee is $12 per $100 loaned, structured as a closed-end loan due the next payday. The CU on Payday website discloses an accurate APR of 292% for a 15-day, $300 loan to members of federal credit unions.[41] Credit unions that follow this approach would be assisting CUSOs in evading state law. Many state credit unions, including some bound by state usury caps that compare to the 18% federal cap, have also offered triple-digit loans through CU on Payday or other CUSOs.[42]

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[37] *See* http://www.myinstacash.com, last visited Sept. 16, 2011). The website solicits applications from both members and non-members. Offering payday loans in states to non-members without proper licensing could have legal implications.

[38] CU on Payday (offering payday loans in the name of at least 10 FCUs and 2 state CUs), Myinstacash (offering payday loans in the name of 1 FCU, Mountain America) and XtraCashLLC (offering payday loans in the name of at least 1 FCU and 2 CUs)

[39] https://www.orlandofcu.org/services/payday_loan.asp (last visited Sept. 21, 2011).

[40] Although not listed on the NCUA website, XtraCash LLC is a CUSO affiliated with Mazuma Credit Union. According to NCUA website CU Holding CO is a CUSO of Mazuma, (Service type: Other-Holding Company). The CUSO's website describes the company as "a short-term lending CUSO" and states that "XtraCash functions as a subsidiary of CU Holding Company, LLC. While CU Holding Company, LLC is the sole owner-investor in XtraCash, LLC, we always welcome the opportunity to discuss new partnerships." The website provides links to payday loan fee charts for KS, MO and FL. The loans all carry triple digit APRs. *See* http://xtracashllc.com/ (last visited Sept. 21, 2011).

[41] For a list of Federal Credit Unions participating in the program see www.CUonPayday.com . One example of such a program is loans to members of Chetco Federal Credit Union in Oregon, loans with terms of 31 days, with an APR of 141% for a $300 loan.

[42] *See* NCLC, *Stopping the Payday Loan Trap*, Appendix A-3 at 37-43.

B) Participation (buying & selling loans) and investments in CUSOs.

It appears that some of these relationships may involve a FISCU funding or selling triple-digit CUSO payday loans. These financial relationships may be designed in this fashion to avoid applicable state consumer loan laws. For example, a credit union in Missouri has a CUSO with a payday lending division. The payday loans are made in Missouri, Kansas and Florida at a fee ranging from $9 to $15 per $100 loaned for a two-week loan, at APRs from 213.79% to 391.07%.[43] It appears that the credit union makes the loans and then sells them to the CUSO, though the loans do not appear on NCUA's 5300 Report. It appears unlikely that the payday lending division is registered as a payday lender with any state. At a minimum, with the credit union based in Missouri, the CUSO office in Kansas, and loans going to three states, it is unclear whether any regulator has effective supervision of the operation.

IV. Payday lending threatens credit union safety and soundness.

Credit unions should strive to place members who need credit into fair, affordable products, not compete with payday lenders. While payday loans that violate the STS guidelines generate sizable fee income in the immediate term, it is an activity that should not be tolerated by NCUA. Just as subprime mortgage lending, where lenders made loans to borrowers unable to repay without serially refinancing them, provided a short-term boost to lenders, they proved untenable in the long-term and threatened the entire American economy. If we have learned anything from the great recession, it is that market growth built upon faulty, abusive products and poor underwriting are unsustainable, and that layering risk on borrowers can compromise safety and soundness.

These short-term, high cost loans siphon critical funds from credit union members, carry reputational risk and could lead to systemic risk if the loans are permitted to proliferate. Payday lending by credit unions poses a number of risks. These risks are not alleviated and in fact are exacerbated when they are made through a third party CUSO.

Credit union payday loans and other high-cost small loan products produce significant systemic risk and are not good business practice. The CUSO role in direct payday

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[43] *See* http://www.xtracashllc.com. For analysis of specific credit unions and CUSOs, *see* NCLC, Letter to NCUA about credit unions engaged in high cost lending, (January 27, 2009), at 5-6, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf.

This Credit Union still offers a payday loan through http://www.xtracashllc.com. Xtracashllc.com does not currently list the credit unions it partners with, but in the most recent press release they report that they serve 23 branches in Kansas, Missouri, and Florida (XtraCash, LLC, Payday loan alternative CUSO XtraCash saves CUs and members $2.8 Million, March 3, 2011, http://www.xtracashllc.com/PDF/XtraCash_CUSO_saves$2.8_million_in_2010.pdf , last visited September 16, 2011). The triple digit rates offered in each state are disclosed on the website as well.

lending, combined with its financial relationships with both state and federal credit unions, augments the risk associated with the products. The performance of these loans will be tied to the financial stability of the CUSO, the parent state-chartered credit union,[44] the other credit unions that have invested in the CUSO, and in some cases the federal credit union that has lent its charter and receives finder's fees for CUSO payday loans. If NCUA allows this type of lending to continue and turns a blind eye to federal credit unions' direct and indirect funding of these practices contrary to express limitations on investments in these types of activities through federal entities,[45] it could increase the share of risky investments on federal credit union balance sheets. The stability of the CUSO can affect all of these entities.

CUSOs owned by or with investments from FCUs are not allowed to engage in payday lending (or even low cost small loan lending). But we have reason to believe that some FCUs may have investments or ownership interests in CUSOs that are involved in one way or another with payday lending, in violation of or circumvention of NCUA rules. This is why NCUA needs to examine all CUSOs more directly to sort out the complicated relationships and to ensure that NCUA rules are being followed.

A) Regulatory risk

Payday lending poses material regulatory risks. Payday lending is exactly the type of asset-based lending discouraged by other federal regulators.[46] The lack of meaningful underwriting and consideration of a borrower's ability to repay the loan heightens the regulatory compliance and oversight burden.

These lending practices also carry significant compliance risks with state and federal laws and the risks are heightened for the credit unions as they may or may not be aware of whether the CUSO is abiding by the various legal requirements.[47]

Public sentiment and state law are moving decisively against payday lending. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected

[44] FCU subsidiary CUSOs are not allowed to do consumer lending beyond mortgage, student loans and credit cards.

[45] 12 CFR § 712.3(b).

[46] *See* e.g., Payday Lending Programs, Revised Examination Guidance, FDIC Financial Institution Letters, FIL-14-2005 at 3 (Mar. 1, 2005) *available at* http://www.fdic.gov/news/news /financial/2005/fil1405a.html (stating that the FDIC "believes that providing high-cost, short-term credit on a recurring basis to customers with longterm credit needs is not responsible lending; increases institutions' credit, legal, reputational, and compliance risks; and can create a serious financial hardship for the customer.").

[47] For a more detailed discussion of the regulatory and compliance risks *see* NCLC, "Letter to NCUA about credit unions engaged in high cost lending," (January 27, 2009), at 6-11, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf

payday lending, despite payday industry campaigns costing tens of millions of dollars.[48] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for a 36 percent annual rate limit on payday loans, rather than the 400 percent that they typically charge.[49]

In addition, since 2007, seven states and the District of Columbia have enacted or enforced meaningful reform to address payday lending[50]—while no state without payday lending has authorized it since 2005.

Federal law and regulation have also moved towards further restriction of payday lending. In 2006, Congress enacted the Talent-Nelson Military Lending Act, which limited loans made to active-duty military personnel and their families to 36 percent annual percentage rate. In 2005, the FDIC imposed the guidelines described above limiting the length of time banks should allow borrowers to be in payday loan debt.[51] And recently, Treasury prohibited payday loan features on prepaid cards onto to which federal benefits are deposited.[52]

B) Business risk

Such loans also pose a business risk. Loans that borrowers cannot repay ultimately harm their lenders. Payday lending is asset-based lending, as the loans are made without regard to a borrower's debt load and/or income. Asset-based lending could lead to a shifting of incentives from serving the community and credit union members to pure fee maximization. Sacrificing membership needs and ignoring the safety and soundness of lending practices (both by credit unions and CUSOs) could compromise the stability of individual CUs and the overall credit union movement.

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[48] In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

[49] In Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. *See* Ronnie Ellis, *Payday Lenders Targeted for Interest Rates*, The Richmond Register (Feb. 8, 2011), *available at* http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates. *See also Poll Reveals strong bi-partisan support for payday lending reform*, Iowapolitcs.com (Jan. 26, 2011), *available at* http://www.iowapolitics.com/index.iml?Article=224730; Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House*, WHSV.com (Jan.18, 2011), *available at* http://www.whsv.com/home/headlines/Virginia_Payday_Lending_Bill_Dies_in_Senate_Survives_in_House_114169549.html.

[50] The seven states are Arkansas, Arizona, Colorado, New Hampshire, Ohio, Oregon, and Montana.

[51] 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.

[52] 31 CFR 212.1, effective as of May 1, 2011.

In spite of NCUA's efforts to date, without rigorous enforcement, payday loans could crowd out fairly structured and priced small dollar loans. The credit union payday loan market may be nascent, but if unchecked, credit union payday loans could grow to be unsustainable, threaten individual charters, and put the CUSIF fund at risk.

C) Reputational risk

Another critical systemic risk is the reputational risk carried by payday lending programs. The credit union movement as a whole could suffer damaging loss of reputation and legitimacy if federal or state credit unions are associated with such predatory practices. This is particularly of concern in the credit union context, where credit unions are currently perceived to closely serve members' interests.

All the federal regulators, including NCUA, have recognized the potentially devastating effect on safety and soundness and the reputational risk of associating with payday lenders who prey on vulnerable consumers. The marketing of credit union payday lending is on the upswing and the accompanying reputational risks are growing in risk and magnitude.

D) Membership risk

Payday loans harm members of credit unions.[53] Payday and other abusive small loan products are particularly harmful at this time when members are at their most vulnerable. The only small dollar credit products that can effectively help credit union members build wealth are loans made at affordable rates and terms long enough to allow borrowers to get back on their feet – rather than a product that ultimately strips wealth while keeping borrowers locked in cyclical debt. Traditional credit union small dollar loans are much better, safer products for borrowers.

E) Charter risk

Making and investing in payday loans also brings the non-profit status of credit unions into question. High-cost, predatory lending made without regard to ability to pay is inconsistent with the purposes of either the federal or state credit union charters. Indeed, both the NCUA and the Eighth Circuit have taken the position that payday lending is inconsistent with a FCU charter. In *Oiciyapi Federal Credit Union v. National Credit Union Admin.*, 936 F.2d 1007 (8th Cir. 1991), the court affirmed the NCUA's decision to dissolve a FCU on the grounds, *inter alia*, that it failed to promote thrift as required by the credit union charter:

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[53] We note that while the Short-Term, Small Amount Loans rule require that borrowers have been credit union members for at least one month, loans made outside of that program (or made without complying with the voluntary program) are marketed to non-members. The impact on consumers is not limited to credit union members.

> The NCUA argues in response that Oiciyapi is not serving any purpose relevant to the goals of the FCUA, and that the very things that keep Oiciyapi solvent and profitable demonstrate that it fulfills no useful function as a federal credit union. Oiciyapi's primary activity, according to testimony and documents in the record, is granting payday loans….Payday loans are not "credit for provident or productive purposes," [12 U.S.C. §1752(1),] as they are not used for investment.[54]

F) National Credit Union Share Insurance Fund (NCUSIF) risk

In the proposal NCUA notes its concern that "'less than adequately capitalized' FISCUs that continue to invest money in failing CUSOs pose serious risks to their members and the NCUSIF."[55] But there is also substantial risk to the NCUSIF fund for the FISCUs engaged in financial relationships with CUSOs that make or facilitate payday loans. Investments based on these payday loan practices, with all of the risks outlined above (such as reputational risk, abdication of sound underwriting etc) could have a cascading impact on the stability of a series of connected actors and put the larger insurance fund at risk. Given that the risk is based on activities that are, by and large, prohibited for FCUs to do directly, it makes little sense for the NCUSIF fund to bear these risks.

V. NCUA should stop credit union payday lending that violate the STS guidelines

NCUA should protect the share insurance fund by immediately stopping direct credit union payday lending that violate the STS guidelines. NCUA should also prohibit all credit unions from engaging in rent-a-charter relationships with CUSOs to facilitate payday lending, whether the financial relationships are characterized as finder's fees, revenues garnered from the selling of/participation in payday loans, or direct (or indirect) investment in or funding of payday operations.

If the small loan regulations are to be effective, NCUA must ensure that credit unions adhere to both the letter and intent of those regulations. NCUA has a well-developed base of legal authority – particularly due to its responsibility for safety and soundness -- to enforce responsible lending practices and sufficient enforcement mechanisms to police the marketplace.[56]

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[54] 936 F.2d at 1011. For a more detailed discussion of the departure from provident purposes and violations of the incidental powers rule *see* NCLC, "Letter to NCUA about credit unions engaged in high cost lending," (January 27, 2009), at 9-11, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf

[55] NCUA proposal at 44867.

[56] *See* NCLC, Letter to NCUA about credit unions engaged in high cost lending, (January 27, 2009), at 6-12, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf.

Policing the market to ensure that FCUs are not offering payday loans that violate the STS guidelines, or other products with predatory features similar to payday loans, is the critical first step in creating a safe and vibrant small dollar loan marketplace. Unless the NCUA actively enforces its regulations regarding permissible fees, some credit unions may simply forego NCUA's 2010 small loan regulations, foregoing the higher interest rate ceiling and instead offering products that include, for example, high application fees that the credit union may attempt to improperly exclude from the APR calculation. NCUA oversight and enforcement is the lynchpin to creating room for good lending practices and products to blossom without being undercut by predatory products and practices.

The FCU charter should not be abused to enable CUSOs or other third parties to avoid State or Federal law. Further investigation and enforcement is required to ensure that FCUs are not using CUSOs to subvert NCUA regulations.

1. **Direct Lending**

As we discuss in section IV there are significant risks in allowing payday lending in the credit union market. Payday loans are inconsistent with the credit union charter as they are not "credit for provident or productive purposes."[57]

Federal Credit Unions and their CUSOs are not permitted to engage in payday lending.[58] Direct lending at triple digit APRs violates NCUA regulations. Federal Credit Union loans are subject to the 28% interest rate cap set forth in the 2010 regulations and for loans outside of that program, the general 18% usury cap. In addition, charging excessive participation and application fees to avoid interest rate limits is an abusive, unfair and deceptive practice, and should be included in APR calculations in any case. Furthermore, Federal Credit Unions making direct payday loans to their members are violating numerous federal laws.[59]

Violations of these rules governing the purposes, activities and permissible loan practices bring all of the risks described in section IV and carry significant safety and soundness

[57] *Oiciyapi Federal Credit Union v. National Credit Union Admin.*, 936 F.2d 1007 (8th Cir. 1991) (quoting 12 U.S.C. §1752(1)).

[58] 12 CFR § 712.3(b), 12 CFR § 712.5.

[59] *See* NCLC, Letter to NCUA about credit unions engaged in high cost lending, (January 27, 2009), at 6-12, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf.

For examples of improper (and repeated, intentional) behavior include providing direct links to CUSO loans on credit union websites. *See* National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't* at 26-27, Appendix A-3 at 37-43 (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf (detailing these practices) (hereinafter *Stopping the Payday Loan Trap*).

risks for FCUs as well as FISCUs. As such, NCUA should prohibit credit unions from directly engaging in payday lending that violates the STS guidelines.

2. Rent-a-charter

A) Finder's Fees

Under existing NCUA regulations, FCUs may not invest in CUSOs that engage in payday lending.[60] In addition, FCUs are barred from investing in or purchasing loans that they are not authorized to make.[61] The Incidental Powers Rule sets guidelines for FCU activities, including finder's fees for certain preapproved activities.[62] However, payday loans are not among those preapproved activities.[63] By accepting finder's fees, FCUs are, in effect, receiving a fee for referring a loan to a CUSO that the FCU could not make directly. As part of any systemic risk analysis, NCUA should investigate the ownership of all payday CUSOs to ensure that no FCUs are violating that rule.[64]

NCUA should give credit unions a warning similar to the one OCC gave national banks back in 2000: "National banks should be extremely cautious before entering into any third-party relationship in which the third party offers products or services through the bank with fees, interest rates, or other terms that cannot be offered by the third party directly. *Such arrangements may constitute an abuse of the national bank charter*.[65]" In addition, NCUA should apply its STS guidelines to any CUSO payday lending, just as FDIC did when it dealt with the renting of bank charters to payday lenders.

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[60] 12 CFR § 712.3(b), 12 CFR § 712.5.

[61] 73 Fed. Reg. 79307, 79310 (Dec. 29, 2008)

[62] 12 C.F.R. § 721

[63] For further discussion of the Incidental Powers Rule *see* NCLC, Letter to NCUA about credit unions engaged in high cost lending, (January 27, 2009), at 6-12, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf; *see also* Comments filed today by NCLC.

[64] For further discussion of the participation and investment rules *see* NCLC, Letter to NCUA about credit unions engaged in high cost lending, (January 27, 2009), at 9-11, *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf. According to press reports, America First Credit Union, a federal credit union, is part owner of a payday lending CUSO.

[65] *See* OCC Bulletin 2001-47, Third Party Relationship Ships, Risk Management Principles at 4 (Nov. 1, 2001), *available at* http://www.ffiec.gov/ffiecinfobase/resources/outsourcing/occ-bul_2001_47_third_party_relationships.pdf (*emphasis added)*.

B) Improperly investing in CUSOs that make payday loans or participating in such loans.

§712.5 establishes "pre-approved activities for CUSOs" and states that "an FCU may invest in, loan to, and/or contract with only those CUSOs that are … engaged in the preapproved activities and services related to the routine daily operations of credit unions."[66] CUSOs of Federal Credit Unions are not permitted to make payday loans – the only consumer lending these federal CUSOs are allowed to do is mortgage, student, and credit card lending.[67] If a federal CUSO is engaging in payday lending it is violation of this section. And a FCU is in violation of sections 712.5 and 712.3 if it invests in such a CUSO.[68] Furthermore, since FCU are prohibited from investing in CUSOs that engage in payday lending, any FCU investments in a CUSO affiliated with a FISCU should also be a violation of the investment rules.

Some federal credit unions are investing in FISCU CUSOs that engage in payday lending, often in violation of state lending laws. NCUA should not only enforce its investment rules, it should expressly prohibit federal credit unions from owning stakes in service organizations that make loans that violate state laws or exceed the STS guidelines. And for safety and soundness reasons, NCUA should do the same for FISCUs that invest in CUSOs making payday loans that violate the STS guidelines.

In some cases, the rent-a-charter relationship may involve the buying and selling of loans. FCUs and CUSOs are barred from investing in or purchasing loans that they are not authorized to make.[69] The same analysis applies as with CUSO investments.

NCUA should prohibit rent-a-charter involving credit unions and CUSO payday lenders. For reasons noted above, the products are abusive and they open credit unions up to systemic risk and reputational risk. The NCUA should follow the lead of other federal regulators and end this abuse before it becomes pervasive.

VI. **NCUA should collect more data regarding payday loans**.

1. Determine third party relationships

As identified in NCUA's current proposal, "without further reporting directly from CUSOs, it is impossible for NCUA to determine which CUSOs maintain relationships with credit unions, the financial condition of CUSOs and the full range of services those

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[66] 12 CFR § 712.5.

[67] *Id*.

[68] *See* 12 CFR § 712.3(b), 715.

[69] 73 Fed. Reg. 79307, 79310 (Dec. 29, 2008)

entities are offering."[70] Not only should CUSO services and products be examined, but that state and federal credit union relationships with CUSOs should be scrutinized as well. Determining the relationships between FCUs and CUSOs (particularly CUSOs affiliated with state credit unions) is critical to ensure that FCUs are not entering into relationships with CUSOs that enable the CUSO to avoid state law and/or the FCU to avoid the regulations established by NCUA.

In the current regulatory environment, the very nature of CUSOs as subsidiaries of FISCUs creates ambiguities that invite risky behavior. As subsidiaries of FISCUs (and therefore subject to varying types of oversight and regulation), it appears that some CUSOs may have been used to skirt legal limitations on consumer lending, third-party fees, sales and participation in payday loans and investments (particularly products, investments and relationships that FCUs are barred from having).

2. Examine CUSOs engaged in payday lending

To the extent that either FCUs or FISCUs are involved in CUSO-related activities that create risk to the share insurance fund, harm to credit union members, and otherwise evade federal and state law, such as payday lending through CUSOs as described in this comment, we strongly agree with the proposal to gather more information. Examining CUSOs, the "nature of their services" and their products to "identify emerging systemic risk posed by CUSOs within the credit union industry"[71] is a critical step to safeguard safety and soundness.

We would propose, however, that NCUA focus its examination on whether CUSOs engage in risky activities -- primarily lending. It seems overly burdensome to require the hundreds of processing CUSOs, such as ATM/debit card networks, core processing vendors, credit card vendors, and the like to be subject to the broad regulatory supervision envisioned in the proposed regulation. As with any proposed regulation, NCUA should focus on the balance between risk and reporting burden. We do not believe a one-size-fits-all regulation for CUSOs is appropriate, and therefore, encourage NCUA to focus attention on CUSOs that have substantial risk-taking activities, especially those involved in payday lending.

We support the proposal to examine CUSOs and to apply the CUSO regulations regarding accounting, financial statements, access to books and reports and maintenance of separate identities to FISCUs. Again, we would propose that NCUA limit its regulation to CUSOs that engage in risky activities -- primarily lending.

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[70] *See* NCUA Credit Union Service Organizations proposal, 76 Fed. Reg. 44866 (July 27, 2011) at 44868.

[71] *See* NCUA proposal at 44867.

3. Collect additional data on credit union payday lending

The NCUA's proposal has identified that for considerations of systemic risk, more oversight and reporting of these CUSOs is necessary. Risk is heightened when a credit union abdicates to a third party underwriting and risk assessment.[72]

Additional data reporting would help NCUA have a better understanding of these transactions but it would not remove the underlying abusive lending practices. As we have stated above, we urge the NCUA to prohibit payday lending that violates the STS guidelines. However, if NCUA issues reporting guidelines prior to such an action, we propose that NCUA also collect data to evaluate the appropriateness of small dollar loan products being offered, including the amount and source of borrowers' income, frequency of use and rollovers, impact on people of color, impact on overdraft and nonsufficient funds (NSF) fees, impact on account closures, the cost to the institution of making payday loans, the amount of finder's fees paid (and to whom) and the amount and frequency of participation or application fees.

4. Extend investment rules

We also support the proposal to apply FCU investment limitations for "less than adequately capitalized" credit unions to FISCUs -- as we commented in section IV, investments in CUSOs involved in payday lending put the insurance fund in peril and should be prohibited due to safety and soundness concerns.

We also recommend extending the rules governing CUSO investments to FISCUs, including §712.3(b), to ensure that FISCUs are not taking significant risks by investing in products and practices that they could not engage in directly. A further safeguard would be to apply §712.5 to CUSOs of FISCUs so that those CUSOs, like Federal CUSOs would not be permitted to engage in payday lending.

5. Increase enforcement

Finally, NCUA should more rigorously enforce the existing lending and investment regulations, particularly once additional data reporting becomes available, and increase coordination with other federal and state regulators.

Broader and more uniform application of the CUSO rules coupled with enforcement should close lending and investing loopholes that are currently being exploited and are allowing high-cost payday lending to gain a foothold in the credit union community and damage vulnerable members. While NCUA already has legal authority over particular activities of federally insured state chartered entities through its safety and soundness responsibility to the share insurance fund, we understand NCUA's position that applying FCU investment and reporting rules to federally chartered or insured credit unions would

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[72] And in these situations reputational risk for the third party may not be paramount as it is for credit unions.

eliminate confusion about interactions between federal and state chartered entities. This consolidation could foster more robust and uniform enforcement of lending and investing regulations, for the good of the credit union market and its members.

VII. Conclusion

We agree that NCUA should gather data and carefully evaluate the systemic risk of CUSO activities and Federal CU and CUSO relationships with state credit unions. NCUA should also more aggressively police the CUSO and CU small loan markets to eliminate the abuses associated with payday products and other high-cost products that violate NCUA regulations as these products and practices subject the credit union market to systemic risk and reputational risk. In conjunction with this effort, NCUA must prohibit indirect payday lending through CUSOs. If credit unions can continue to be able to evade existing NCUA rules, there will be no reason for them to offer more affordable alternatives.

In addition, NCUA should immediately act to protect the insurance fund by stopping direct credit union payday lending that violate its STS guidelines. As part of this effort, NCUA should prohibit all credit unions from engaging in rent-a-charter relationships with CUSOs to facilitate payday lending, whether the financial relationships are characterized as finder's fees, revenues garnered from the selling of/participation in payday loans, or direct (or indirect) investment in or funding of payday operations.

NCUA should also use its full examination and enforcement authority to ensure that federal credit unions are not improperly investing in state CUSOs or receiving finder's fees for loans that they are prohibited from making as federal credit unions.