Arkansans Against Abusive Payday Lending

www.StopPaydayPredators.org
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July 2, 2010

Mary Rupp, Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Re: Comments on Notice of Proposed Rulemaking (Short-Term, Small Amount Loans)

Dear Ms. Rupp:

I appreciate the opportunity to comment on NCUA's proposed regulation on what are commonly known as Payday Loan Alternatives and what NCUA has proposed as a "Short-Term, Small Amount Loans (STS loans)." NCUA is proposing to allow Federal credit unions to charge members interest in excess from 18% APR (up to 28% or 36% APR) under circumstances as spelled out in this proposed regulation.

Oftentimes members with "colorful" credit history (with credit scores in the C, D or E category) have turned to predatory payday lenders. Many members have the income to repay the loan in reasonable installment payments, but will end up trapped for long periods of time if required to repay the loan in a single balloon payment. Fully amortized installment payments for a reasonable term and at a reasonable interest rate above 18% APR would be very helpful to Federal Credit Unions and their members.

I believe approving a higher interest rate by NCUA for STS loans to higher risk members and providing the guidelines in the proposed regulation will encourage more credit unions – not only Federals, but with this guidance, also state chartered credit unions – to offer Payday Loan Alternatives loans that are useful to members, particularly those members that tend to live from payday to payday. However, I feel that some changes ought to be considered as explained below:

1. **Interest Rate Ceiling** – NCUA is proposing to allow Federal Credit Unions to charge members up to 1000 BP higher than the current ceiling of 18% APR. Making small loans to members with "colorful" credit dictates that credit unions take some additional risk and to do that they need to be compensated with additional interest. Charging up to 28% APR (or up to 36% APR) should be well received by some credit unions as a way to provide a needed service to an additional 20% of their members (who are currently using payday lenders) by extending small dollar loans to their members that they are not now extending.

2. **Application Fee** – The proposed application fee limit concerns me. While Regulation Z expressly excludes certain charges from the definition of finance charge 12CFR 226.4(c) (1) states, in part "…The fee may cover the costs of services such as credit reports, credit

investigation, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. However, if the fee is to be excluded from the finance charge under 226.4(c) (1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit."

A careful reading of this section and an insider's knowledge of the mortgage lending business makes it clear why mortgage loans are mentioned by the Federal Reserve in this section. Credit reports for mortgage loans are usually much more complicated and expensive than for consumer loans. Usually for a mortgage loan all three credit bureaus are contacted and differences in the reports are reconciled as a part of the approval process. Also, credit investigation is very thorough and time consuming with written verification being requested for all assets and debts. Additionally, because real property is involved an independent appraisal is obtained. Due to the expense of these services (usually over $500), the weeks involved in the approval process, the fact the loans being applied for are very large (usually in excess of $100,000), the cost for these services is nearly always collected by the lender when the loan is applied for and paid out to third parties.

STS loans however, (in my opinion) do not justify application fees. Traditional payday lenders do not run credit bureau reports, but instead use a report from Teletrack – a subprime credit tracking agency. Instead of costing $2.50 like a traditional credit bureau report on most consumer loans Teletrack reports cost $0.45 each after a minimum charge of $95 for the first 100 reports per month. Additionally, the members using these loans should not be subjected to additional fees, especially if the loan is rejected as these are members struggling to make ends meet from payday to payday.[1]

If NCUA's proposed rule is approved as written and a member received a minimum loan of $200 loan with a minimum repayment period of one month and a maximum interest rate of 28% APR and a maximum application fee of $20 the cost for the loan would be $25.19 and the interest rate (including all fees) would be 142.639% (see enclosure A).

Suggested Alternative - I would much rather see NCUA increase the interest rate limit to 36% APR including all upfront fees. The Department of Defense rules for loan to the Military, their spouse, and dependents require that no lender charge more than 36% and requires that any upfront fees be considered in the APR which they call the "Military Annual Percentage Rate." What is good enough for the military community ought to be good enough for civilian borrowers as well.

3a. Maturity (loan term) – The minimum and maximum maturity NCUA is proposing also concerns me. While traditional payday loans have a 14 – 31 day term this is one of the reasons those loans are so predatory. Borrowers have a very difficult time repaying their loans in a single balloon payment. Credit Unions and nearly all lenders (except payday lender and title pawn lenders) make loans with installment payments. Installment payments have allowed Americans for decades to own their own homes, cars, and other durable goods by making small, affordable payments over a reasonable period of time.

STS loans with installment payments can be made affordable to credit union members, but the terms NCUA has proposed are too restrictive. A one month $200 loan (even at 36%, with no application fee) would require a member to pay $206.09 in a single monthly payment (see enclosure B). A much more reasonable approach would be to make the minimum term four months. This would require the member to make a much more affordable payment of only $53.86 per month (see enclosure C). Of course, if the member wanted to pay the loan in a single payment they could do so and they would only pay the interest for one month because there is no pre-payment penalty on credit union loans.

For larger dollar loans of $1000 the proposed maximum term is six months. This would require the member (even with a 36% APR and no application fee) to pay $184.87 every month for six months which is a pretty large payment (see enclosure D). A much more reasonable approach would be to make the maximum term eighteen months. This would require the member to make a much more affordable payment of only $72.98 per month (see enclosure E). Of course if the member wanted to pay the loan in a single payment or six monthly payments they could do so and they would only pay the interest for the period the loan was outstanding because there is no pre-payment penalty on credit union loans.

Not only would the extended maximum term from 6 months to 18 months benefit the member through lower, more affordable payments, but the credit union would benefit with increased interest income. A $1,000 loan at 36% APR and no application fee repaid over a 6 month period would only garner the credit union $109.20 in interest (see enclosure D). That same $1,000 loan at 36% APR and no application fee repaid over an 18 month period would garner the credit union $313.62 in interest income (see enclosure E).

3b. Minimum Amount - $200 – The NCUA proposal calls for loans from $200 to $1000. I would suggest you lower the lower limit from $200 to $100 simply because members may have that small a need. Additionally all states that allow payday loans, allow loans for as low as $100, some even allow loans as low as $50. There is no reason that I can see to limit to loans at least $200 so I would suggest the lower limit be reduced from $200 to $100.

3c. Maximum Amount - $1000 - Concerning the upper limit of $1000 this is quite generous, but I believe proper. All states that allow payday loans limit the amount of individual loans to somewhere between $250 to $500. Some states go a little higher, but no state approaches $1000. Even states like South Dakota and Delaware which have no limit on the amount of interest that can be charged borrowers limits the maximum amount of a traditional payday loan to $500.

Why then would I encourage NCUA to allow a maximum loan twice as large? Because I believe that many loans will be made by credit unions to bail their members out from existing high interest, balloon payment, and predatory payday loans. Because the typical payday loan is about $300-$350 this would allow a Federal Credit Union to help members who already owe two or three traditional payday lenders pay those lenders off and start with a clean slate.

4a. Cap on Loan Volume – NCUA stated in their proposal that the Board is thinking of limiting loan number and total dollar amount of STS loans and asked what such a cap should be. The state regulator in Texas suggested in a recent regulatory proposal (91.720) that Texas state chartered credit unions be limited to an "aggregate total of all small-dollar credit products outstanding, however, shall not exceed 20% of the credit union's net worth." For a $250,000,000 credit union with 10% capital this would be a limit of $5,000,000 for STS loans which certainly seems adequate.

4b. Underwriting – One of the predatory practices of traditional payday lenders is not inquiring or even caring what other outstanding debts their borrowers have. Members are not well served when they are granted loans that they cannot repay when they are due. It is thought that payday lenders approve everyone, but that is just not true. They disapprove about 25% of all applicants through the use of Teletrack, a subprime reporting agency. I would believe that credit unions would disapprove about 40% - 50% of applicants if they underwrite loans and determine that the member can actually afford to pay their monthly payments on all their debts including the STS loan.

I would suggest that credit union also obtain a traditional credit report because I have been told that about 10% of the time a credit union is able to convert an application for a Payday Alternative Loan to a mainstream credit union product like a traditional signature loan, home equity loan, etc.

While it is important to verify income (both the level and the probable continuation) requiring members (by regulation) to produce two pay stubs is unnecessary. Some members can only prove their income through tax returns while others have their pay direct deposited directly into their credit union each payday. While credit unions should verify income in their underwriting process exactly how they verify it may (and should) differ from member to member.

Additional Comments- While your Proposed Rule did not ask about the following areas I believe the following suggestions could improve the Final Rule and allow both credit unions, members and NCUA to have a more complete regulation if thought was given to the following:

Open End Lending – While this proposal as written speaks to closed end loans and does not include open-end loans I think it ought to. The majority of credit unions provide open end loans to their members and many do not even offer closed end loans. While this may change the fact is that many credit unions that currently offer Payday Loan Alternatives do so as open end loans. I suggest that the STS loan final rule include a 36% APR rate ceiling and no upfront fees (participation or application fees) on both open-end and closed-end loans.

24 Month Pilot Period – The FDIC offered banks a similar proposal two years ago. They have just completed their 24 month Pilot Program. During this period they have gathered detailed statistical information from each bank in their pilot. I am **not** suggesting that NCUA's final rule be only a Pilot Program, but I am suggesting that detailed information be gathered from all credit unions about Payday Alternative Loans currently being offered to their members. These statistics should be gathered through the 5300 Report process for non-STS loans, STS loans, and third party payday type loans being offered by credit unions to their members.

Additional Guidance – Just this month two detailed studies have been released that could help NCUA in the development of their final rule. The National Consumer Law Center published a study titled "*Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't*" that contains wonderful information on how to develop an alternative loan that helps borrowers. Sadly the Study also includes a number of misguided credit unions that are currently making triple digit payday type loans. Maybe NCUA's STS loan rule will give those credit unions a creditable alternative.[2]

Also in June, 2010 the Federal Deposit Insurance Corporation issued their final report "*Template for Success: The FDIC's Small-Dollar Loan Program.*" Maybe the results of this report can be useful to NCUA in writing their final rule.[3]

Summary – The sad fact is the product as offered by payday lenders is simply defective because it is designed to trap borrowers into a needless cycle of debt just to enhance the income stream of predatory payday lenders. Credit unions are better lenders than that and they can design a product that will help members and not entrap them. The Credit Union Movement has helped members for over 100 years in America with provident and productive loans and they have the opportunity, with NCUA's leadership, to continue that proud tradition.

Sincerely,

H. C. "Hank" Klein
Founder/Director

H. C. "Hank" Klein retired in 2005 after a 41 year career in the Credit Union Movement. His final position was as President/CEO of the largest credit union in Arkansas where he served for 18 years. In addition to his employment in the Credit Union Movement he also served as a volunteer board member in many credit union trade associations and vendors. Upon retirement he used his knowledge of financial services and founded Arkansans Against Abusive Payday Lending (AAAPL), a broad-based coalition of 40 non-profit, consumer, community, civic, military and faith-based organizations.[4]

After nearly five years of hard work by the Coalition shinning the light of day on the tactics used by local payday lenders and how they were harming borrowers the Arkansas Supreme Court and Attorney General took action and was successful in totally removing predatory payday lending from Arkansas. The last payday lender left Arkansas on July 31, 2009. During this experience Klein learned a lot about what makes these loans predatory (it isn't just the triple digit interest rate) and so difficult for borrowers to pay back on the due date without re-borrowing over and over again for months and often years. Klein has also helped dozens of "victims" and he has learned firsthand just what a debt trap payday loans really are.

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[1] http://www.teletrack.com
[2] http://s98001.gridserver.com/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf
[3] http://www.fdic.gov/smalldollarloans/
[4] www.StopPaydayPredators.org

Enclosure A

Advanced APR Calculator

Loan Amount (*C*):	200
Extra Cost (*E*):	20
Interest Rate % (*R*):	28
Compound Frequency (*m*)	Daily (365/Yr)
No. of Payments (*N*):	1
Payment Frequency (*q*)	Monthly (12/Yr)

APR: 142.6390 %

Payment:	**$225.19**
Total Payment:	**$225.19**
Total Interest:	**$25.19**

Detailed Payoff Schedule

Enclosure B

Advanced APR Calculator

Loan Amount (*C*):	200
Extra Cost (*E*):	0
Interest Rate % (*R*):	36
Compound Frequency (*m*)	Daily (365/Yr)
No. of Payments (*N*):	1
Payment Frequency (*q*)	Monthly (12/Yr)

Calculate Again

APR: 36.0000 %

Payment:	**$206.09**
Total Payment:	**$206.09**
Total Interest:	**$6.09**

Detailed Payoff Schedule

Enclosure C

Advanced APR Calculator

Loan Amount (*C*): 200

Extra Cost (*E*): 0

Interest Rate % (*R*): 36

Compound Frequency (*m*) Daily (365/Yr)

No. of Payments (*N*): 4

Payment Frequency (*q*) Monthly (12/Yr)

APR: 36.0000 %

Payment:	**$53.86**
Total Payment:	**$215.45**
Total Interest:	**$15.45**

Detailed Payoff Schedule

Enclosure D

Advanced APR Calculator

Loan Amount (*C*): 1,000

Extra Cost (*E*): 0

Interest Rate % (*R*): 36

Compound Frequency (*m*) Daily (365/Yr)

No. of Payments (*N*): 6

Payment Frequency (*q*) Monthly (12/Yr)

APR: 36.0000 %

Payment: **$184.87**

Total Payment: **$1,109.20**

Total Interest: **$109.20**

Detailed Payoff Schedule

Enclosure E

Advanced APR Calculator

Loan Amount (*C*):	1,000
Extra Cost (*E*):	0
Interest Rate % (*R*):	36
Compound Frequency (*m*)	Daily (365/Yr)
No. of Payments (*N*):	18
Payment Frequency (*q*)	Monthly (12/Yr)

Calculate Again

APR:	**36.0000 %**
Payment:	**$72.98**
Total Payment:	**$1,313.62**
Total Interest:	**$313.62**

Detailed Payoff Schedule