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July 6, 2010

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NAFCU Comments on Notice of Propose Rulemaking (Short-term, Small Amount Loans)

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions (FCU), I am writing to you regarding the National Credit Union Administration's (NCUA) proposed rule on short-term, small amount loans (STLs). NAFCU supports efforts to encourage credit unions to offer small dollar loans, as we believe these programs will help attract more people into the traditional banking system.

The proposed rule details two different options for the small dollar loan program; one option is an APR of 28 percent plus a $20 application fee and the alternative is a 36 percent APR with no application fee. NAFCU recommends the NCUA consider a third option. Rather than increasing the APR beyond 18 percent, NAFCU believes it would be preferable to keep the APR at 18 percent and clearly define the term "finance charge" for purposes of STLs. While the NCUA has historically adopted the definition of "finance charge" in Regulation Z, there is no statutory requirement to adopt the same definition. Accordingly, it would be preferable if the agency kept the current APR, and defined "finance charge" in a way that still encourages credit unions to offer these loans.

If the agency is intent on using one of the two alternatives discussed in the proposal, NAFCU prefers allowing a 28 percent APR with a $20 application fee. Many of these loans are very small and are paid off very quickly. Consequently, the higher 36 percent APR, inclusive of all fees may not be sufficient to encourage credit unions to participate. For example, assume a member takes out a loan for the minimum amount of $200 and pays it off two weeks later. The interest income even at the higher 36 percent APR is so small that is simply would not make sense for most credit unions to devote the time and resources necessary to write and manage the loan. The lower APR coupled with the $20 application fee strikes the appropriate balance between encouraging these loans and consumer protection. While NAFCU believes the lower APR with the application fee is the better of the two alternatives, we also would encourage the NCUA to provide credit unions the flexibility to use one method or the other, based on the particular circumstances of each member.

The preamble to the proposal makes clear that the Board does not intend to force credit unions to alter existing small dollar loan programs as it states,

> "This proposal does not address or alter the applicable regulations governing these (open-end) products and does not prohibit open-end programs that are currently permissible. In addition, this proposed rule would not prohibit an FCU from continuing or participating in a closed-end payday loan program that currently operates successfully and is legal under NCUA's regulations and the Federal Reserve Board's Regulation Z…." 12 CFR part 226." Short Term, Small Amount Loans, 75 Fed. Reg. 24497 (May 5, 2010).

NAFCU would simply ask that the agency state as much in the text of the regulation to make clear that credit unions with existing small dollar programs will not have to make changes in order to comply with this rule.

NAFCU agrees that credit unions should limit these types of loans through their written lending policies. Authorizing each credit union to make that determination, individually, is preferable to the NCUA setting bright line rules for the entire credit union industry in this regard. These loan programs are unlikely to generate significant income for credit unions. Consequently, in order to encourage the programs the NCUA should provide credit unions as much flexibility as possible. Many credit unions will likely choose not to even explore implementing such a program if they feel the regulatory requirements are too strict.

The limits in the lending policies should be some percentage of the credit union's assets, rather than a hard dollar cap or a cap on the number of loans. Capping the STS program based on assets, rather than a hard dollar amount, or loan amount will provide credit unions the flexibility they need to grow or shrink their program as necessary without constantly updating the written lending policy. Alternatively, the proposal could authorize the lending policy to tie the program to a percentage of assets with an additional requirement that the credit union set a maximum dollar amount. This would allow credit unions flexibility in administering the program with a hard cap that, if reached, would force institutions to reevaluate the program. Again, NAFCU stresses the importance of providing credit union's flexibility in this regard. Given that these programs will only be marginally profitable, if at all; there is little reason to fear that credit unions will grow their programs to a size that may prove unsafe or unsound. Consequently, the agency should provide credit unions flexibility in order to ensure there is an incentive to offer an STS program in the first place.

NAFCU does not support tying participation in an STS program to the member's agreement to participate in a payroll deduction or direct deposit program. First and foremost, such a condition would seemingly conflict with Regulation E, which states, "No financial institution or other person may condition an extension of credit to a consumer on the consumer's repayment by preauthorized electronic fund transfers, except for credit extended under an overdraft credit plan or extended to maintain a specified minimum balance in the consumer's account." 12 C.F.R. 205.10(e)(1). Thus, requiring STS borrowers to participate in a direct deposit program would appear to directly conflict with Regulation E.

Next, such a requirement would be unfair for individuals whose employers do not offer direct deposit. Individuals should not be granted or denied a loan based on a matter that is entirely outside their control. Further, this proposal is aimed, at least in part, at attempting to draw more people into the traditional banking system. While, that effort obviously needs to be made in a safe and sound manner, the agency should take care to minimize, as much as possible, barriers to entry. Requiring a payroll deduction is one more barrier that will likely discourage potential members. Certainly, payroll deduction will improve the likelihood of repayment; nonetheless we believe credit unions can still make these loans in a safe and sound manner without a payroll deduction requirement. Given that such a requirement would conflict with Regulation E, would unfairly impact certain individuals for whom direct deposit is not available, and would serve to discourage at least some individuals from participating, NAFCU opposes a direct deposit or payroll deduction requirement.

NAFCU believes that it would be best if STS loans are amortized, however, the final regulation should not prohibit balloon payments. In some cases a balloon payment simply would not make sense. Moreover, in any case where a member is in a cycle of debt, requiring a balloon payment would provide little benefit as it would only reinforce that cycle. However, in some cases where a member requires only a small loan for a short period of time, there should be no prohibition on allowing a balloon payment if that is the member's preferred method of repayment. Making larger payments in order to pay off the loan in a more timely manner saves the member money. Thus, there seems little reason to prohibit this method of repayment in cases where the member requests it. Further, the proposal already prohibits rolling loans over. The prohibition on rollovers will do much to solve the problems that often arise from balloon payments as pay day lenders often use balloon payments as a way to force the consumer to apply for a new loan. Again, a blanket prohibition on a balloon repayment will only serve to encourage members and prospective members to seek loans from other lenders who are subject to little if any regulatory oversight.

Best Practices

NAFCU has several thoughts regarding the section of the rule addressing best practices. First, the proposed rule could benefit from some drafting changes that would make the regulation better reflect the policy described in the preamble. Second, while NAFCU opposes a length of membership requirement for STS loans, we believe it would be reasonable to include such a provision in the best practices.

Based merely on reading the proposed regulation it is not clear that the best practices are not required – as the preamble suggests. In discussing the best practices, the preamble states, “Although the Board is not proposing specific underwriting standards, risk avoidance methods, or program features, FCUs should consider the ‘best practices,’ discussed below…These practices are not regulatory requirements, but FCUs should consider them in developing an STS program” Id. at 24500. The proposed regulation, however, plausibly leads to a different conclusion. The proposal, states,

> “In developing a successful STS loan program, a federal credit union *should* consider how the program will help benefit a member’s financial well being while considering the higher degree of risk associated with this type of lending. The guidance and best practices are intended to help federal credit unions minimize risk and develop a successful program, but are not an exhaustive checklist and do not guarantee a successful program with a low degree of risk.” Id. at 24501 (emphasis added).

Reading only the proposed regulation, one might reasonably conclude that the best practices – rather than being a mere suggestion – are actually a floor detailing the minimum, specific, standards that credit unions must employ. Accordingly, NAFCU makes two suggestions to clarify this issue. First, subsection B should specifically state that credit unions are not required to follow the best practices, as the preamble states. Second, NAFCU recommends adding the words “below” to the sentence, “The guidance and best practices are intended to help federal credit unions….” Id. With the modification, the sentence would read, “The guidance and best practices below are intended to help federal credit unions….” While these changes are minor, NAFCU believes they will clarify (1) the best practices that the rule references; and (2) that those best practices are suggestions and not regulatory requirements.

Next, NAFCU opposes a length of membership requirement for STL loans as it is an additional barrier, likely to discourage participation. Currently, many credit unions that offer small dollar loans do have length of membership requirements. Such a requirement obviously may be beneficial as it provides the credit union more information regarding the borrower’s history. Many members or potential members who need an STS loan either want or need the loan immediately and do not have the luxury of waiting three to six months. Consequently, a regulatory requirement to that effect will likely push potential members towards payday lenders with higher fees and fewer protections. Accordingly, NAFCU believes, if this requirement is to be included at all, it should be a suggested best practice that credit unions may choose to follow or modify as they see fit. For example, it may make sense for a credit union to, generally, require some minimum length of membership, while giving loan officers the authority to override the requirement on a case-by-case basis.

On a final note, NAFCU encourages the NCUA to work with defense credit unions to ensure that they do not run afoul of Department of Defense (DoD) regulations that protect servicemembers from loans with an APR in excess of 36 percent. As you are obviously aware, DoD regulations also have certain restrictions the effective APR on closed-end loans of 91 days or less. While we do not envision this being problematic, we simply would ask that the agency take care to make sure that the NCUA requirements are in accord with the DoD regulations.

NAFCU appreciates this opportunity to share its comments on the proposal. Should you have any questions or require additional information please call me at (703) 842-2212.

Sincerely,

Dillon Shea

Dillon Shea
Associate Director of Regulatory Affairs