

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

RIN 3133-AE08

Payday-Alternative Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Advance Notice of Proposed Rulemaking (ANPR).

SUMMARY: The NCUA Board (Board) is currently reviewing its regulation governing payday-alternative loans (PAL or PAL loans), formerly known as short-term, small amount loans. The Board intends to improve the regulation to encourage more federal credit unions (FCUs) to offer PAL loans and believes it may be necessary to amend the regulation. The Board seeks comment on how best to approach this. Although the Board identifies specific issues for discussion below, it encourages commenters to discuss any issue related to improving the regulation.

DATES: Comments must be received on or before [INSERT DATE THAT IS 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- NCUA Web Site: http://www.ncua.gov/RegulationsOpinionsLaws/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include “[Your name] Comments on Advance Notice of Proposed Rulemaking for Part 701, PAL Amendments” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

PUBLIC INSPECTION: You may view all public comments on NCUA’s website at <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx> as submitted, except for those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA’s law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518–6546 or send an e-mail to OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Frank Kressman, Associate General Counsel, Office of General Counsel, at the above address or telephone (703) 518-6540.

SUPPLEMENTARY INFORMATION:

I. Background

A. The PAL Rule

B. Evaluation of PAL Data and Justification for the Rulemaking

II. Questions for Comment

I. Background

A. The PAL Rule

On September 16, 2010, the Board amended its general lending rule to enable FCUs to offer PAL loans, previously referred to as short-term, small amount loans, as an alternative to predatory payday loans.¹ PAL loans can help certain members to break free of their dependency on high-cost payday loans. To help FCUs afford to make PAL loans, which tend to have higher rates of default than mainstream loan products, the PAL rule permits FCUs to charge a higher rate of interest for PAL loans if certain conditions are met.

The term “payday loan” generally refers to a small amount, short-term loan that is intended to cover a borrower's expenses until his or her next payday, which is when the

¹ 75 FR 58285 (Sept. 24, 2010).

loan is to be repaid in full.² Historically, payday loans have been made by lenders who charge high fees and often engage in predatory lending practices. While some payday loan borrowers use these loans sparingly, many find themselves in a cycle of having their loans “rollover” repeatedly, and they incur more high fees as a result. These borrowers are often unable to break free of this unhealthy dependence on payday loans.

As part of the solution, the Board is determined to provide a regulatory framework for FCUs to make PAL loans a viable alternative to predatory payday loans. The Board intends the PAL loan rule to provide short- and long-term benefits for current payday borrowers. In the short term, the rule provides borrowers with a responsible alternative to high-cost payday loans. In the long term, the rule permits FCUs to offer borrowers a way to break the cycle of reliance on payday loans by building creditworthiness and transitioning to traditional, mainstream financial products.

The current PAL regulation permits FCUs to charge an interest rate for PAL loans that is 1000 basis points above the general interest rate set by the Board for non-PAL loans, provided the following conditions are met:

(1) The principal amount of the PAL loan is not less than \$200 and not more than \$1000;

² NCUA Instruction 10200, Credit Union Online Instruction Guide, page 32 (12/2009).

(2) The PAL loan has a minimum maturity term of one month and a maximum maturity term of six months;

(3) The FCU does not make more than three PAL loans in any rolling six-month period to any one borrower and makes no more than one PAL loan at a time to a borrower;

(4) The FCU does not rollover any PAL loan;

(5) The FCU fully amortizes the loan;

(6) The FCU sets a minimum length of membership requirement of at least one month;

(7) The FCU charges an application fee to all members applying for a new PAL loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20; and

(8) The FCU includes, in its written lending policies, a limit on the aggregate dollar amount of PAL loans made to a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.³

The rule also includes a best practices section, which discusses ways to help ensure the product remains viable and responsible.

³ 12 CFR §701.21(c)(7)(iii).

B. Evaluation of PAL Data and Justification for the Rulemaking

In the 2010 rulemaking, the Board indicated that, after one year, it would review the PAL loan data collected on the 5300 call reports and reevaluate the requirements of the rule.⁴ As of September 30, 2011, 372 FCUs reported offering PAL loans with an aggregate balance of \$13.6 million on 36,768 outstanding loans. Six months later, as of March 31, 2012, approximately 386 FCUs reported offering PAL loans with an aggregate balance of approximately \$13.5 million on 38,749 outstanding loans.

The Board notes that, during this six-month period, there was a slight increase in the number of participating FCUs, and it commends those FCUs that offer PAL loans to their members. The Board intends to increase the participation level in a meaningful way and ensure that all FCUs that choose to offer PAL loans are able to recover their costs.

The Board acknowledges that some FCUs may choose not to offer PAL loans because their members do not need them. Further, the Board recognizes that some FCUs offer other non-PAL loan products and services to their members that also reduce dependence on traditional payday lenders. Nevertheless, there are many credit union members who would benefit greatly from enhanced access to PAL loans. Accordingly, the Board is committed to making PAL loans a more widespread product for those members who need them and making it easier and more affordable for those FCUs that choose to offer them. NCUA advises that an FCU can only make PAL loans available to its members if the FCU can afford to make these loans.

⁴ Id. at 58288.

II. Questions for Comment

The Board is considering ways to improve the PAL regulation. An increase in the permissible application fee may enable FCUs with higher application processing costs to afford to offer PAL loans to their members. The Board understands that actual costs to process an application may be higher for some FCUs based on geographic location or the level of underwriting a particular FCU chooses to conduct. While the Board does not expect FCUs to generate a large return from these loans, it does not expect FCUs to offer PAL loans at a loss, which could threaten the FCUs' safety and soundness.

The Board could consider increasing the permissible application fee without making any other changes or it could increase the fee in conjunction with a decrease in the permissible loan interest rate. The Board understands that some credit unions prefer not to charge a higher interest rate on PAL loans, but must do so to offset the higher degree of risk associated with these loans. The Board invites comment on if a higher application fee cap alone would encourage more credit unions to make PAL loans or if credit unions would prefer any application fee increase to be linked with a lower permissible interest rate.

Although the Board is considering increasing the maximum application fee, the Board notes that under Regulation Z (Reg Z), an application fee may only serve to recoup the actual costs incurred by an FCU to process a PAL loan application. FCUs would still need to accurately account for their costs in determining a permissible application fee, and they would not be able to use this fee to offset losses associated with this type of

lending. NCUA will continue to scrutinize these fees to ensure compliance with Reg Z and ensure PAL loans remain a beneficial product for FCU members.

In addition to seeking comment on the application fee and interest rate, the Board seeks comment on all aspects of the regulation. The questions enumerated below are intended to stimulate commenter response and suggest areas where NCUA may improve the rule to encourage more FCUs to offer PAL loans. Commenters should feel free to comment on any aspect of the PAL regulation. Of course, commenters should include reasonable justification for all comments provided.

Additional Questions for Consideration:

(1) Should the Board increase the permissible PAL loan interest rate, which is currently set at 28% (based on 1000 basis points above the maximum interest rate established by the Board for non-PAL loans)?

(2) Should the Board expand the permissible loan range, which is currently set from \$200 to \$1000?

(3) Should the Board permit PAL loan maturities of shorter than one month or longer than six months?

(4) Should the Board allow FCUs to make more than one PAL loan at a time to a borrower?

(5) Should the Board eliminate or decrease the one-month minimum length of membership requirement?

(6) Should the Board increase the limit on the permissible aggregate dollar amount of loans made, which currently is 20% of an FCU's net worth?

In addition to soliciting comments on the current PAL rule, the Board is also interested in learning about viable payday-alternative products credit unions are currently offering their members. The Board invites commenters to describe products and programs they offer and to share details about the business models they use to execute successful programs.

By the National Credit Union Administration Board on September 20, 2012.

Mary Rupp
Secretary of the Board