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July 26, 2018

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

RE: Comments on Notice of Proposed Rulemaking (PALs II)
RIN 3133-AE84

Dear Mr. Poliquin,

We are writing on behalf of Kinecta Federal Credit Union (Kinecta), one of the nation's largest credit unions, with approximately $4.4 Billion in assets, serving 300,000 members. We appreciate the opportunity to provide comment on the National Credit Union Association's (NCUA's) Notice of Proposed Rulemaking regarding Payday Alternative Loans (PALs) posted in the Federal Register on June 4, 2018. As most credit unions are devoted advocates for the consumer, we are writing this letter in hopes that it will help the NCUA understand consumer needs, as well as the credit unions' potential role in an industry lacking lenders whose main goal is not to turn a profit, but to help consumers of modest means.

We commend the NCUA's efforts in addressing the needs of consumers who turn to payday lenders during a time of financial need; however, we do not believe that the current PAL product approach focuses on the true needs of the consumer nor does it afford the flexibility for credit unions to devise a tailored payday alternative that meets the need of the consumers within the communities that they serve. We believe that our suggestions will assist the NCUA in developing a payday lending alternative that meets NCUA safety and soundness objectives and is also a better payday alternative for consumers.

There are more than 50,000 non-depository locations in the U.S. that provide costly alternative financial services. It is estimated that 12 million borrowers spend more than $9 billion on payday loans each year. Consumers rely on payday loans to meet everyday expenses for food, utilities, rent, or daycare, borrowing at annual percentage rates that typically exceed 300 percent. Most of these consumers have low credit scores, but they do have both regular income and an active checking account, the two requirements to get a payday loan. Those customers are not among the 7% of households that are unbanked; rather they are among the 20% of households that are underbanked, meaning they hold an account at a credit union or bank, but they also meet some of their needs by going to alternative financial services providers.

Factoring in loans such as payday, auto title, pawn, rent-to-own, and subprime installment, consumers spend well over $30 billion annually in interest and fees for small-credit from non-depository institutions. Most people who use high-cost loans end up paying more in fees and interest than they originally received in credit. These loans can put customers' checking accounts at risk. One study found that payday loans were associated with increased risk of checking account loss, probably because staying solvent becomes harder when consumers are trapped in payday loan debt. Another study found that 22% of online payday loan borrowers reported losing or closing their checking accounts in connection with an online payday loan. These outcomes are not just bad for consumers, but they're bad for credit unions, both because they can cause members' accounts to charge off when they're negative, and because they cause us to lose members who provide payday lenders with access to their checking account on payday as loan collateral.

Credit unions are positioned to serve as a better alternative if NCUA regulation allows. The typical payday loan borrower takes a $375 loan, has it out for five months of the year, and pays $520 in fees on top of the $375 in principal. Under the proposed pricing limits we recommend, credit unions could provide the same $375 for the same five months at a cost of $84-94, or roughly six times less than what payday lenders charge. The typical auto title loan borrower uses a $1,000 loan and ends up paying more than that in fees alone. Rent-to-own customers often pay four times more than mainstream retail prices for basic goods like household appliances and furniture. The Pew Charitable Trust estimates a partial shift from these high-cost loans into safer alternatives from credit unions and banks could save consumers more than $10 billion annually—more than the U.S. government spends on many of our anti-poverty programs.

PAL Proposal

We appreciate the Board's commitment to enhancing the PAL loan by expanding its features within this proposal. We believe that the proposed expansion of loan amount from $1,000 to $2,000 and loan term from 6 to 12 months coupled with the removal of the 30-day membership length requirement are beneficial improvements. But as a response to this proposed rulemaking and request for information, we provide additional specific feedback about how to enable credit unions to safely offer small-dollar loans at scale in a way that would both enhance safety and soundness and provide a mutually sustainable option for a large share of the 20% of American households who use both depository institutions and alternative financial services. We feel that prescribing a product bounds the credit unions to a specific structure and does not support innovation. Specifically, extensive research has found that many households cope with income volatility, so their incomes may be more than adequate to meet their expenses in some months, but fall short in others. This problem may be especially acute for the roughly 80 million Americans who are paid hourly. Expanding the loan structure to include closed-end and open-end credit would afford a greater degree of flexibility for credit unions to design a loan program that meets the needs of the communities in which they operate. A small-dollar line of credit would probably better meet their needs than a series of closed-end loans.

Recommendation: We ask that the Board view this small-dollar credit issue holistically, creating one unified PAL program to simplify understanding and compliance for credit unions. The program should have three options, encompassing the loans envisioned in PAL I and II, but also permitting another option that would enable credit unions to reach their members who most need help and use a new small-credit offering to bring in new members. To do this, we encourage the Board to shift towards designing a program framework of principles under which credit unions can offer sustainable payday alternative loans that provide adequate revenue for providers and flexibility and access to borrowers. Below is an example of principles and conditions under which credit unions can structure their own payday alternative loan programs.

NCUA lending principles for payday lending alternative loans:
- All lending products, disclosures and practices comply with applicable laws and regulations;
- Underwriting or qualifying criteria based on proof of recurring income or employment;
- Contains or encourages the use of saving features or financial planning/counseling;
- Reporting of borrower's repayment history to the credit bureaus.

Should the lending product meet these principles, the credit union will be allowed to charge 1,800 basis points over the Board established interest rate cap, provided that the loan meets the following conditions:
1. Loan amount is no more than $4,000;
2. Term is 1 to 36 months;
3. APR does not exceed 36% (1800 basis points over rate cap);
4. Application fee does not exceed $50 for closed-end loans;
5. Annual participation fee does not exceed $50 for open-end loans;
6. No more than one loan at a time to a borrower;
7. Roll-overs are prohibited;
8. Loans amortize fully to a zero balance;
9. Loans repaid in substantially equal installments;
10. Aggregate dollar amount of loans does not exceed 20% of net worth. Low-income designated credit unions or those that participate in Community Development Financial Institutions program are exempt.

We believe that this approach would allow credit unions greater flexibility to devise tailored alternative payday lending products that meet and address the needs of their communities and incite innovation while preserving safety and soundness objectives.

Comments on whether to include some or all of the features of PALs II in PALs I
We believe that combining PALs I, II, and III is appropriate and operationally effective. The concepts outlined in PALs II and expanded on in our recommendations better address the needs of consumers by potentially allowing them a longer term, higher loan amount, and faster availability with the removal of

the 30-day membership requirement. The CFPB's safe harbor is really the only advantage to PALs I and it is not a great enough advantage to sustain the product on its own, especially if it would require additional reporting by the credit unions on the 5300 Call Report, which although not addressed in the proposal, is an area of concern for credit unions. Similarly, the loans made which fall outside the PAL I exemption criteria would have terms of at least 46 days, so they would not be covered at all by the CFPB's final small-loan rule.

We recommend there be just one PAL program, and that it have three components: a closed-end version, an open-end version, and an exempt version. The versions we describe are similar enough that it would be simpler to just have one program.

1) **Should the Board propose a third alternative PALS rule and why?**
   Today, roughly 9 percent of federally insured credit unions offer the PAL loan. As proposed, we do not believe that PAL I and PAL II are enough to encourage substantially more credit unions to enter the market or for current PAL providers to make the investment necessary to scale up their programs. Credit unions must have a product that not only promotes safety and soundness, but meets consumer demand.

   Recommendation: We recommend NCUA set regulatory parameters, not a specific product, in order to provide flexibility to credit unions to create a product that is marketable in their region. Regulatory parameters should be permissible for either an open or closed end credit. A scalable and sustainable program would enhance safety and soundness both by putting these programs on a stronger financial footing, and also by keeping credit union members in a regulated environment rather than turning to high-cost lenders.

2) **Should the Board set the permissible interest rate for PALs III loans above that permitted for other PALs loans? If so, why and what legal justification supports a higher interest rate?**
   A survey conducted by the PEW Charitable Trust found that 3 in 4 of those surveyed felt that an $80 fee for a loan of $500 paid back over 4 months was fair. This roughly represents a 74% interest rate. 80% of Americans and 86% of payday loan borrowers believe a $400, 3-month loan for $60 is fair—an 88% rate. While we do not advocate such rates, the current rate of 28% does not yield enough revenue to invest in the automation and outreach necessary to promote and maintain a competitive and sustainable safe payday lending alternative.

   Recommendation: We recognize that Federal Credit Unions have an interest rate ceiling for loans. We ask the Board to consider expanding the 1000 basis points allowed for payday alternative loans (PALs I and II) up to 1800 which would allow credit unions to offer a maximum rate of 36% APR. This rate has been used by: Congress in the Military Lending Act to restrict the prices charged to military members and their families; the CFPB to differentiate between loans under the longer-term section of the final small-dollar loan rule; the FDIC as part of their small-dollar loan pilot; and many states for one or more of their consumer lending statutes. While the difference between a 28% and

36% rate on small loans is not large in dollar terms, it is likely to make the difference between whether PAL continues to be a low-volume program used by a small share of credit unions or one that provides a true alternative for a large share of members who lack access to safe small credit today.

3) **Should the Board increase in PALs III the maximum amount an FCU can charge for an application fee above that permitted for other PALs loans?**
The application fee serves as non-interest revenue that allows credit unions to cover the costs of operating a small-dollar loan program. We recognize that revenue from application fees should not be used to cover losses, but we believe it will be important for the viability of programs that application fee revenue can be used to pay service providers, invest in loan processing automation and program technology generally, and promote the program so consumers use these loans rather than high-cost ones. While not all credit unions charge an application fee, having the ability to charge an application fee allows for program flexibility and as an added revenue stream for these small-dollar loans to cover application processing expenses other than losses.

Recommendation: The Board should consider increasing tbe application fee that reflects the actual costs associated with processing the application to a maximum of $50 for all closed-end PAL loans. We believe that $50 affords credit unions greater flexibility in covering staff and technology costs related to processing an application. In addition, we encourage the Board to clarify that "costs associated with processing applications for credit" include all costs related to applications, such as investing in technology and automation, ensuring potential applicants are aware of the program, and paying third-party providers that can help lower the costs of application-related lending activities such as underwriting, processing applications, and originating loans.

4) **Should the Board allow FCUs to make more than one kind of PALs loan at a time to a borrower?**
Credit unions are not looking to be like payday lenders; our desire is to offer a better alternative to our members to help them improve their financial lives. We do not believe borrowers should be allowed more than one PAL loan at a time nor should we encourage recurring use of PAL loans.

5) **Should the Board set in PALs III the limit on the aggregate dollar amount of loans made above that permitted for other PALs loans?**
We believe that the current Board limit of 20% of net worth has been traditionally appropriate for 9 percent of credit unions that currently offer PAL loans. We anticipate; however, that our recommendations will encourage larger participation and shift more credit unions into this space, particularly those that are from low-income designated credit unions or credit unions that participate in the Community Development Financial Institutions program.

Recommendation: The Board should exempt a federally insured credit union that has a low-income designation, or participates in the Community Development Financial Institutions program from the 20% of net worth provision. This exemption is aligned with the existing exemption under Part §723.8 Member Business Loans.

6) **Should the Board eliminate for PALs III the requirement that FCUs implement appropriate underwriting guidelines?**
No, the Board should not eliminate the requirement that FCUs implement appropriate underwriting guidelines, but we recommend the Board clarify that the use of paystubs is only necessary for new members or members who lack regular deposits into their checking accounts.

7) **Should the Board set for PALs III the maximum loan amount above that permitted for other PALs loans?**
Although we anticipate that a majority of loans will be for less than $2,000, there are a sizable share of auto title, payday installment, and traditional subprime installment loans that are above $2,000. Based on this information, we believe that the appropriate limit would be $4,000. Giving credit union members the flexibility to access loans of $2,000-$4,000 could help keep members from turning to high-cost loans if they seek more than $2,000.

8) **Should the maturities for PALs III loans be longer than those permitted for other PALs loans?**
We anticipate that most loans will have terms of 24 months or shorter, but we recommend the Board permit terms up to 36 months for two reasons. First, if the loan is greater than $2,000, many members will require more than 24 months to repay. Second, a line of credit is helpful in keeping costs down because the credit union only needs to originate once, and then members can draw and pay down the balance as needed. Allowing terms up to 36 months maximizes flexibility for members using lines of credit and keeps costs lower for credit unions originating these lines.

9) **Should the Board permit PALs III to include an open-end loan product?**
    a. **If the Board permits an open-end product, should the Board allow FCUs to charge participation fees, provided the fees are not considered a finance charge under Regulation Z?**
    b. **If the Board permits participation fees on an open-end PALs product, should the Board set a maximum cap on that fee, and, if so, what should the maximum amount be?**

Yes, the Board should consider allowing PALs III to include an open-end payday alternative product. Should the credit union choose to charge a participation fee, it should be allowed, as it is currently permissible under Regulation Z. If the maximum rate permitted is only 28%, the Board should not place a cap on participation fees, as the fee should be at the discretion of the credit union and disclosed under the requirements of Regulation Z. But if the Board gives credit unions the flexibility to charge up to 36% APR, as we recommend, then capping an annual participation fee at $50 is reasonable because of the added revenue provided by the higher interest rate.

10) **Should the Board require FCUs to conduct an ability to repay determination in PALs III similar to that required by the CFPB's Payday Loan Rule?**
Each credit union should be allowed to implement their own guidelines to determine members' ability to repay at their discretion. The CFPB's ability-to-repay requirements would raise the cost of both origination and compliance. The CFPB's ability-to-repay requirements were focused on very high-cost loans because those loans pose great risk to consumers. The loans envisioned under our recommendations for the PAL program would typically cost about six times less than payday loans, so they pose little risk to consumers.

11) **Should the Board prohibit FCUs from charging overdraft fees for PALs loan payments drawn against a member's account?**
As mentioned throughout this letter, a PALs product provided by credit unions should be a better alternative for borrowers; charging an overdraft fee would not assist our member-borrowers in improving their financial lives. Thus we encourage the Board to prohibit credit unions from charging an overdraft fee for PALs loan payments drawn against their account.

We appreciate your efforts to address the needs of members who turn to payday lenders during a time of financial crisis. We hope our comments will provide you with information to develop parameters that will assist these consumers, encourage credit union participation and further enable credit unions to meet their mission of serving members of modest means.

Thank you for providing Kinecta Federal Credit Union the opportunity to comment on this proposal and for your consideration of our comments.

Sincerely,

Luis Peralta
SVP Chief Administration Officer
Kinecta Federal Credit Union
cc: CUNA, CCUL, NAFCU