Center for Economic Integrity

July 30, 2018

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

Re: Payday Alternative Loans, Proposed Rule, 12 CFR Part 701, RIN 3133-AE84

Dear Secretary Poliquin:

Arizona based Center for Economic Integrity (CEI) submits these comments in response to the National Credit Union Administration (NCUA or the Board)'s proposal to expand its payday alternative loan program. The Center for Economic Integrity is a nonprofit organization founded in 2001 whose mission is to build economically strong communities for all and opposes unfair corporate practices. CEI has been on the forefront here in Arizona in the ongoing public debate surrounding the debt trap that payday and car title loans create and the harms that they cause to our local economies and our citizens. This docket is especially important to consumers in Arizona because although payday loans are not authorized by law in this state, car title lenders are permitted to make loans at rates up to 204 percent APR with almost no consumer protections. Car title lenders have created harmful shot-term small loan products that are for all intents and purposes payday loans using regulatory loopholes to continue to extract over $300 million dollars in revenue per year. Almost every year, high-cost lenders seek legislation to authorize triple-digit rate loans with unfavorable terms, often with the claim that consumers have no alternatives for credit. Credit unions fill a vital role in our communities by offering safe, affordable, responsible small loan options.

Federally chartered credit unions have been authorized to make NCUA's "Payday Alternative Loan" or PAL at rates 1000 basis points higher than the federal usury cap for credit unions, resulting in a current ceiling of 28 percent annual interest plus a fee to cover costs up to $20 for loans of $200 to $1000. The current proposal adds a PAL II loan product that permits loans up to $2,000 at rates higher than the federal usury cap. Before we discuss the proposed provisions of the PAL II, we would like to point out that credit unions can and do meet the credit needs of their members by offering loans at or below the federal usury cap.

Last year the Arizona Community Action Association surveyed credit unions and other providers to catalog the options available to consumers who need small loans.[i] They identified 41 credit unions (both state and federally chartered) that offered one or more loan products of $500 or less in fourteen counties. These loans cost less than 18 percent APR, do not incur fees beyond the annual credit union membership fee, help build credit, have no pre-payment penalties, are easy to apply for and do not require collateral. In some instances, no credit check is needed and the loan includes a savings option. Of these surveyed credit unions, 13 credit unions are state chartered and not subject to the NCUA PAL rule. Of the federally-chartered credit unions operating in Arizona, four reported PAL loans in their most recent NCUA call reports (Coconino, EM, Rim Country, and Sunwest credit unions). The ACAA survey illustrates that the vast majority of small dollar lending takes place outside the higher-cost PAL program. While the survey could not test the credit-worthiness threshold for loans, their survey indicates that small dollar lending is available at reasonable cost and accessible terms without raising the federal usury cap.

In considering how far outside the federal usury cap credit unions should be permitted to go, it is important to recognize that credit unions can and do serve small dollar loan needs with existing affordable products outside of PAL programs, including the small dollar loans offered in Arizona, overdraft lines of credit, signature installment loans and credit cards. These loans are better for consumers than the PAL I program which structures loans as payday loans with a sizeable upfront fee charged each time the credit is extended (subject to PAL I limits but no limits for the proposed PAL II.) Credit unions also offer free financial counseling and savings plans to help consumers improve their finances. We hope that NCUA will continue to encourage federal credit unions to offer these mainstream products and services rather than expanding permitted extra fees under a PAL II or an anticipated PAL III program.

Recommendation: Limit the number of permitted application fees to one per year

We urge the Board not to make any changes to the current PAL I program that would make it more likely that credit union members would end up in cycles of high-cost, short-term loans that look a lot like payday loans. The PAL II proposal to permit loans with no minimum size, no limit on the number of loans per year, and no limit on fees puts consumers at risk. The PAL I rule permits no more than three loans up to $1,000 with a $20 application fee every six months. The proposed PAL II rule permits loans up to $2,000 and sets no limit on the number of loans a borrower can have (other than one loan at a time) and permits unlimited applications fees. This structure will encourage unlimited loan flipping, a hallmark of the payday loan industry.

Permitting an administrative fee for every loan issued under the PAL II program drives up the cost of credit to consumers. For example, a one-month $200 loan with two semi-monthly payments which is renewed every month for a year effectively provides $200 in credit to the consumer for a year at an annual cost of $240 in fees plus the 28 percent interest. The APR for this series of loans would be over 120 percent. Since the PAL II proposal sets no minimum loan size, this scenario could happen with a $100 loan at over 240 percent APR.

This proposed unlimited fee structure provides incentives for credit unions to become more like payday lenders with a fee-per-loan model for debt trap lending. Once a credit union has issued the first loan to a member, underwriting and application processing should be much less expensive than the initial loan. One loan application fee per year should be the limit. Even licensed Consumer Lenders in Arizona are prohibited from charging another loan origination fee for the refinancing of a closed end consumer loan within one year of the collection of a prior loan origination fee. (A.R.S. 6-635(A)(4)(a)). NCUA should set at least this high a standard for federally-chartered credit unions by limiting PAL II loans to one administrative fee per year, regardless of the number of loans issued.

Recommendation: Preserve the federal usury cap for credit union loans

The 18 percent annual usury cap for federally-chartered credit unions does not apply to loans made under the PAL program which permits rates of 1000 basis points higher than the federal cap, currently 28 percent, for loans that meet the terms of the PAL program. The Board is proposing that the size of PAL II loans be doubled to $2,000 to qualify for this much higher rate. We are very concerned about continued erosion of the important federal usury ceiling for credit unions, especially for larger loans.

We strongly oppose NCUA proposing a PAL III program with even larger loan sizes and more expensive terms for members. Nonbanks will use any erosion of credit union protections to lobby for changes to state laws that govern consumer lenders, payday and car title lenders which will make expensive and predatory loans more prevalent. Raising fees or rates further would invite a race to the bottom among all lenders.

Recommendation: Support strong underwriting for loans

Underwriting for credit union loans should be based on ability to pay, considering both income and expenses, especially for higher cost products targeted at financially distressed consumers who struggle to make ends meet. Given that the PAL II proposal removes the one-month credit union membership requirement, this larger expensive loan product will be available to a much larger segment of the population than can now use the smaller PAL I product. With no prior membership required, the credit union will have less information on potential borrowers.

Recommendation: Improve incentives for credit unions to serve the small loan needs of their members by curbing abusive overdraft fees and practices

The revenue that credit unions get from charging overdraft fees to their members who struggle to make ends meet provides a disincentive to offer responsible small dollar loan products. In order to encourage credit unions to be effective in meeting the small loan needs of members, NCUA should address high-cost overdraft programs by advising that credit unions not charge overdraft fees on debit card point-of-sale and ATM transactions; make any overdraft fees reasonable and proportional to cost; and limit overdraft fees to one per month and six per year. These changes would help members be less vulnerable to payday and title loans.

Credit unions pride themselves as membership driven organizations exiting primarily to meet the needs of its members. The relationship and trust that credit unions have with its members is developed over time and is not based on extracting huge profits for the lending institution but on building long-term customer and community relationships. These relationships are based on the principles of fairness, transparency and integrity. Arizona credit unions, large and small, state chartered and federally chartered hold themselves to a high ethical standard. The proposed PAL II and PAL II put that standard and the reputation of the entire credit union industry at risk.

We thank NCUA for considering our comments.

Sincerely,

Kelly S. Griffith
Executive Director
Center for Economic Integrity

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[i] https://azcaa.org/wp-content/uploads/2018/07/Payday_Alternatives_Guide-REV-031318.pdf
https://azcaa.org/reports/