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August 2, 2018

Gerard S. Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street Alexandria, VA 22314
Via email: regcomments@ncua.gov

RE: Notice of Proposed Rulemaking, Part 701, Payday Alternative Loans II (RIN 3133-AE84)

Dear Mr. Poliquin:

Happy Mango Inc. appreciates the opportunity to comment on the proposed Payday Alternative Loans (PAL) II rule. Happy Mango is a financial technology company. We provide a low-cost online lending platform that helps banks and credit unions reduce processing costs and minimize loan losses.

We applaud NCUA's commitment to providing credit union members affordable alternatives to payday loans. We support NCUA's permitting an extra 1000 basis points on top of the statutory interest rate for PAL loans so that credit unions may offer affordable small-dollar loans as a viable business.

We believe additional PAL products (PAL III) are necessary to meet credit union members' needs and to make PAL a sustainable business for credit unions. In response to NCUA's solicitation of comments on the possibility of creating a third PALs loan program (PALs III), we have the following recommendations:

1. **Add line of credit as a permissible product**
2. **Raise the interest rate and application fee cap from those under PAL I and PAL II**

We are making the above recommendations based on our observation of the lending activities on our platform and on research compiled from relevant sources.

1. Add Line of Credit to Meet the Growing Needs of Millions of Credit Union Members

Expanding PAL with a line of credit can help millions of credit union members who are at risk of becoming payday borrowers. For lower income consumers, many of them credit union members, there is a shortage of affordable cash flow management products, and this shortage will worsen as income volatility rises.

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Today credit card is the most common cash flow management product in the market. However, a significant number of lower income consumers cannot get a credit card. To qualify for a credit card, one generally needs a credit score above 600. The Consumer Financial Protection Bureau (CFPB) estimates that 45 million Americans, or 20% of US adult population[1], do not have credit score, and another source estimates that one third of the remaining 80% have scores below 600[2]. That is, close to half of American consumers (approximately 100 million) do not qualify for credit cards will need an alternative for managing cash flow volatility. Many of them are credit union members.

And their need will only grow because income volatility is rising. A JP Morgan Institute study[3] concluded that "Americans experience tremendous income volatility, and that volatility is on the rise." The study estimates that 55% people experience more than 30% change in month-to-month income. With the continued expansion of the online labor platforms (e.g. UBER, Handy) which provides opportunistic but not so stable sources of income, such volatility will only rise. Without a line of credit, the most convenient way to shore up cash flows for those credit union members who do not qualify for credit cards will be a payday loan.

Given the lack of an existing product to address the growing cash flow challenges faced by a large number of credit union members, we recommend expanding PAL program to include line of credit as a permissible product.

2. Raise Interest Rate and Application Fee Cap to Make PAL a Sustainable Program

Our financial forecast model indicates that small- to mid-sized credit unions will likely lose money participating in the current PAL program. Even large credit unions will suffer months of loss before they can ramp up the program to a scale of self-sustainability. We recommend that the interest rate cap be raised from 28% to 36% and that application fee cap be raised from $20 to $50 so that it will be economically viable for more credit unions to participate in the PAL program.

With interest rate capped at 28% per annum and application fee capped at $20, the unit revenue on PAL products is extremely low. Even with complete automation, PAL products under these terms won't break even until a certain scale is reached. Some credit unions may never reach that level of scale. For others, the ramp up period to achieve such scale can last from 6 months to 24 months, depending on

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[1] The CFPB Office of Research, "Data Point: Credit Invisibles" (2015) https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf

[2] Credit.com, "How Many Americans Have Bad Credit? (2016) http://blog.credit.com/2016/02/how-many-americans-have-bad-credit-136868/

[3] JP Morgan Chase Institute, "Understanding Income Volatility and the Role of the Online Platform Economy" (2016) https://www.jpmorganchase.com/corporate/institute/insight-online-platform-econ-income-volatility.htm

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the portfolio mix and the credit union's available resources. During this time, the credit union will have to sustain an operating loss in addition to investing in marketing and technology to launch the PAL program. The initial cost to launch and a protracted period of negative net income may have deterred many credit unions from participating in the program.

Our revenue forecast model (see Exhibit A) assumes complete automation and a write-off rate of 5%. The results indicate the following:

- PAL I at 28% interest rate and $20 application fee reaches break-even at a scale of over 4,050 applications per year or 340 applications per month;
- PAL II at 28% interest rate and $20 application fee reaches break-even at scale of over 360 applications per year or 30 applications per month.

Our experience indicates that it takes an average 6 to 12 months for mid-sized financial institutions (assets between $150 million and $1 billion) with moderate marketing budget to reach 30 applications per month on a steady basis and more than 12 months for large-sized financial institutions (assets above $1 billion) with dedicated marketing department to reach 350 applications per month.

Raising the interest rate cap to 36% and application fee cap to $50 can shorten the time for PAL loans to reach sustainability. With higher interest and application fees,

- PAL I at 36% interest rate and $50 application fee reaches break-even at a scale of over 1,545 applications per year or 130 applications per month;
- PAL II at 36% interest rate and $50 application fee reaches break-even at a scale of over 246 applications per year or 20 applications per month.

Under the current caps, small- to mid-sized credit unions (see Exhibit B) will almost certainly lose money by offering only PAL I products. They will struggle to reach break-even even with the subsidy of PAL II products. However, if the caps are raised, then a small- to mid-sized credit union could reach break-even with a balanced portfolio when it reaches a scale of 900 applications a year or 75 applications a month.

An 8% increase in interest rate and a $30 increase in application fee cap from the current levels can open the door for many more credit unions to participate in the PAL program, offering consumers significantly more attractive alternatives to payday loans that charge over 400% in fees and interests.

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In conclusion, we believe PAL I and PAL II offer a promising starting point from which the PAL program can expand. The NCUA has taken admirable effort in addressing the significant unmet consumer demand for affordable cash-flow management products. We look forward to supporting this effort with cost-saving technology and helping more credit unions participate in the PAL program in a sustainable way.

Sincerely,

Kate Hao

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Exhibit A: Minimum number of applications to reach break-even

	Minimum Scale to Reach Break-Even			
	Under Current Terms		Under Recommended Terms	
	PAL I	PAL II	PAL I	PAL II
Average Loan Product				
Interest Rate on Loan	28.00%	28.00%	36.00%	36.00%
Funding Costs	1.50%	1.50%	1.50%	1.50%
Average Loan Amount	$500	$1,500	$500	$1,500
Average Loan Term (Months)	3	12	3	12
Application Fee	$20.00	$20.00	$50.00	$50.00
Unit Application Processing Cost				
Automated Processing Cost per Application [1]	$3.00	$3.00	$3.00	$3.00
Credit Metrics				
Application Rejection Rate [2]	25%	25%	25%	25%
Write-Off [2]	5.0%	5.0%	5.0%	5.0%
Operational Metrics				
Number of Applications Processed per Year	4,050	360	1,545	246
Number of Loans Funded per Year	3,038	270	1,159	185
Number of Full Time Staff [3]	1	1	1	1
Staffing Cost	$75,000	$75,000	$75,000	$75,000
Processing Software Cost [1]	$18,000	$18,000	$18,000	$18,000
Annual Loan Volume	$1,518,750	$405,000	$579,375	$276,750
Average Loan Portfolio Balance	$379,688	$405,000	$144,844	$276,750
Annual Profitability Estimate				
Interet Income	$106,313	$113,400	$52,144	$99,630
Interest Expense	$5,695	$6,075	$2,173	$4,151
Net Interest Margin	$100,617	$107,325	$49,971	$95,479
Loan Loss	$75,938	$20,250	$28,969	$13,838
Net Revenue from Loans	$24,680	$87,075	$21,002	$81,641
Non Interest Income	$81,000	$7,200	$77,250	$12,300
Non Interest Expense	$105,150	$94,080	$97,635	$93,738
Annual Net Income	***$530***	***$195***	***$617***	***$203***

Notes:

1. Processing Software and Per Application costs reflect cost of using Happy Mango
2. Write-Off and rejection rates are based on the average of loans underwritten on Happy Mango system
3. With complete automation, only 1 loan officer is assumed to be dedicated to running the program

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Exhibit B: Mid-Sized Credit Union Break-Even Analysis

	Mid-Size Credit Union			
	Under Current Terms		Under Recommended Terms	
	PAL I	PAL II	PAL I	PAL II
Average Loan Product				
Interest Rate on Loan	28.00%	28.00%	36.00%	36.00%
Funding Costs	1.50%	1.50%	1.50%	1.50%
Average Loan Amount	$500	$1,500	$500	$1,500
Average Loan Term (Months)	3	12	3	12
Application Fee	$20.00	$20.00	$50.00	$50.00
Unit Application Processing Cost				
Automated Processing Cost per Application[1]	$3.00	$3.00	$3.00	$3.00
Credit Metrics				
Application Rejection Rate [2]	25%	25%	25%	25%
Write-Off [2]	5.0%	5.0%	5.0%	5.0%
Operational Metrics				
Number of Applications Processed per Year	450	450	450	450
Number of Loans Funded per Year	338	338	338	338
Number of Full Time Staff [3]	1	1	1	1
Staffing Cost	$75,000	$75,000	$75,000	$75,000
Processing Software Cost [1]	$18,000	$18,000	$18,000	$18,000
Annual Loan Volume	$168,750	$506,250	$168,750	$506,250
Average Loan Portfolio Balance	$42,188	$506,250	$42,188	$506,250
Annual Profitability Estimate				
Interet Income	$11,813	$141,750	$15,188	$182,250
Interest Expense	$633	$7,594	$633	$7,594
Net Interest Margin	$11,180	$134,156	$14,555	$174,656
Loan Loss	$8,438	$25,313	$8,438	$25,313
Net Revenue from Loans	$2,742	$108,844	$6,117	$149,344
Non Interest Income	$9,000	$9,000	$22,500	$22,500
Non Interest Expense	$94,350	$94,350	$94,350	$94,350
Annual Net Income	***-$82,608***	***$23,494***	***-$65,733***	***$77,494***

Notes:

1. Processing Software and Per Application costs reflect cost of using Happy Mango
2. Write-Off and rejection rates are based on the average of loans underwritten on Happy Mango system
3. With complete automation, only 1 loan officer is assumed to be dedicated to running the program