

Cooperative Credit Union Association

Creating Cooperative Power

August 3, 2018

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

Cooperative Credit Union Association, Inc. Comments on Notice of Proposed Rulemaking Payday Alternative Loans RIN 3133-AE84

BY EMAIL ONLY

Dear Mr. Poliquin:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. (“Association”), please accept this letter relative to the National Credit Union Administration’s (“NCUA”) Notice of Proposed Rulemaking on Payday Alternative Loans. The Association is the state trade association representing credit unions located in the states of Delaware, Massachusetts, New Hampshire, New Jersey and Rhode Island, serving approximately 180 credit unions which further serve approximately 3.9 million consumer members.

The Association commends the NCUA for its efforts in providing credit unions with additional options to offer payday alternative loans. The current PALs regulatory framework allows credit unions to be a viable alternative to high-cost payday lenders. The Association supports NCUA’s endeavor to provide additional options and expand opportunities for credit unions in the small-dollar, short-term marketplace.

The demand for small dollar, short-term credit is high, and credit unions have seen firsthand how their members have been taken advantage of and experienced challenging situations exacerbated further by predatory lenders claiming to offer a solution. The PALs program is a model for consumer protection, and provides an alternative to the predatory payday loan market for short-term, smaller-dollar loans to members who face an unexpected expense, and who are then able to turn to their trusted credit union financial partner for help. The PALs program recognizes credit unions as responsible lenders, and provides a balance between consumer protection and safety and soundness for credit unions which recognizes their structural differences and history of consumer protection, and encourages them to meet the very significant demand for this type of lending.

In preparation for the development of the present comment letter, to foster a consensus, and to assist in providing detailed comments, the Association conducted a survey of all credit union members in order to

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Cooperative Credit Union Association, Inc.

845 Donald Lynch Blvd., Marlborough, MA 01752-4704 • Tel. 508.481.6755 • 800.842.1242 • Fax: 508.481.3586

assess the impact that this proposal would have on our member credit unions. This letter incorporates those views.

Impact on Responsible Local Lenders

NCUA's most recent Call Report data shows that with the exception of New Hampshire, credit unions in each of the Association's member states report offering PALs loans. Delaware credit unions report 2,243 outstanding PALs loans totaling \$1,112,989; Massachusetts credit unions report 62 outstanding PALs loans totaling \$24,044; New Jersey credit unions report 1,571 outstanding PALs loans totaling \$774,480; and credit unions in Rhode Island report 18 outstanding PALs loans totaling \$10,255. In Delaware, the average delinquency rate is 1.39% and average net charge-off rate is 0.76%; in Massachusetts, average delinquency rate is 2.85% and average net charge-off rate is 0.46%; in New Jersey, average delinquency rate is 2.78% and average net charge-off rate is 1.29%; and in Rhode Island, average delinquency rate and net charge-off rate are 0.00%.

This data on PALs-specific products does not tell the complete story, however, as local credit unions have long been a resource in their communities for small-dollar loans. Local credit unions regularly offer small-dollar loans tailored to the needs of their members, particularly during key cycles, such as the holidays when an unexpected expense during an already demanding time could leave a member without a basic necessity such as transportation or heat. Whether it be such a holiday loan, an unforeseen auto repair loan, a Smart Start Loan that features small-dollar amounts for gap-bridging purposes, a Credit Building Loan which deposits funds into a savings account for the term of the loan to build credit,¹ all of which are offered at local credit unions currently, these PALs-like loans which feature flexible underwriting are occurring every day in member states.

History in New Hampshire provides further support. In a collective community outreach effort, credit unions throughout New Hampshire committed to offer unsecured Emergency Loans. These unsecured loans were made based on need and the promise to repay, normal underwriting standards were waived. The first emergency loans were \$500 fuel loans made to families who were having trouble heating their homes. This program has been expanded at many credit unions to include medical emergencies (such as necessary but uninsured dental care) and transportation loans. Over half of all loans made by a \$3 million in assets credit union in Groveton were made under this umbrella.

The Association's survey revealed that of the member credit unions that participate in a small dollar, payday loan substitute program, the driving force behind the credit union's decision to enter the small-dollar loan marketplace is member demand and need. Of those surveyed who have not yet entered the marketplace, top motivating factors would be member demand and the need to be a safe alternative to predatory loans. Profitability to the credit union, while a factor, was considered less important. In fact, survey respondents who participate in payday alternative programs currently reported that these loans make only a small profit.

¹ Auto repair loan program current being offered by DEXSTA Federal Credit Union, Wilmington, Delaware; Smart Start Loan program currently being offered by Navigant Credit Union, Smithfield, Rhode Island; Credit Building Loan program currently being offered by Metro Credit Union, Chelsea, Massachusetts.

A Flexible Approach Will Improve PALs Program

The Association and its member credit unions support the expansion of options in the payday alternative marketplace. Credit unions have a history of making safe and affordable small loans since their inception. Credit unions provide safe and importance products and services that their members need, rely on, and ask for.

The stated intent of this proposal is to ensure that all federal credit unions that are interested in offering PALs loans are able to do so and the Association agrees that more flexible terms for PALs loans will make the program more viable. While the intent behind this proposal is laudable, and options are welcomed as additional tools in the toolbox, the Association notes that the more complex and prescriptive a program appears, the more likely to invite discouragement and deter increased participation. For example, one credit union respondent stated that multiple rules for the same product causes increased compliance burden and a greater opportunity for errors. Compliance costs and considerations combined with entry costs associated with entering the payday alternative marketplace remain a concern for credit unions.

Cognizant of the compliance burden, therefore, it is the position of the Association that additional flexibility and streamlining is necessary to make these programs work well. The Association suggests, therefore, that NCUA's final payday alternative proposal provide credit unions and consumers with as much flexibility as possible to tailor short-term, small-dollar loans to their needs, without being overly prescriptive. While all suggested recommendations can be incorporated into the proposal as it stands, the Association would be supportive should NCUA choose to reissue an original PALs proposal that does not contain as many distinctions between PALs I, PALs II, and PALs III programs, and instead merge concepts into a cohesive, singular PAL program that provides flexible ranges.

Overall member consensus demonstrates that a holistic approach to payday lending alternative programs, that allows for flexibility and encourages innovation, is preferable. It is important that parameters be established allowing individual credit unions, who are more keenly aware of their members' and market's needs, to manage their own underwriting. As such, a final PALs rule should include parameters for streamlined, but solid, underwriting. The Association suggests that any requirements in a final PALs proposal provide flexible ranges under which credit unions may tailor small dollar, short-term lending products according to their regional, market, and consumer needs.

Relative to loan maturity, the Association suggests that a longer loan term is key to program success because it provides more time for members to recover from a financial emergency than the single pay cycle for payday loans, or the immediate repayment often required for fee-based overdrafts. Therefore, the Association would support flexible loan maturity ranges from one (1) to twelve (12) months.

Regarding loan amounts, higher amount loans are often an important part of a credit union's payday alternative business plan. Oftentimes, members need and can qualify for larger loans. Such loans often cost the credit union the same amount to originate as smaller-dollar loans, and may result in higher revenues. Survey respondents indicate that a higher loan amount provides more flexibility for credit unions to assist their members' needs. Given the rising costs of everyday items, the current \$1,000 level is not sufficient. A credit union should be able to decide whether a minimum is necessary, and whether it can exceed the \$1,000 loan amount depending on its member's need.

When asked whether credit unions should be able to make more than one kind of PALs loan at a time to a borrower, responses were varied. While the majority of respondents indicated that this would be a positive feature, the overwhelming response was that it would depend on the situation, and that the individual credit union should be left to make an experienced credit decision based on its established underwriting criteria. Comments focused on the importance of the individual member's needs and best interest, which may or may not at any given time call for more than one PALs loan at a time.

The majority of respondents felt that a final rule should not prohibit credit unions from charging overdraft fees for PALs loan payments drawn against a member's account. Commenters felt that if a PAL is offered, it should have the same attributes of other unsecured personal loans. However, comments again noted the importance of leaving such a judgment up to the individual credit union. A credit union empowered with the ability to waive an overdraft fee under specified circumstances and parameters contained in policy, and/or include an education component about the costs of not having sufficient funds to make a payment, is in an ideal position to make a decision in the best interest of its member.

Similar comments were reflected when asked about the restriction on the number of PAL loans provided within a certain timeframe. The overarching comment was that situations can differ, and this determination should be left to the individual credit union and its member. This position was also held when asked whether there should be a restriction on the number of times one can modify an existing loan.

Commenters opined that a final PALs rule should not contain a limit on the aggregate dollar amount of loans made separate from that permitted for other PALs loans. Comments focused on the concept that a PAL loan is a PAL loan, and therefore should be treated similarly. However, again, comments referenced the need for this determination to be made by individual credit unions, and that part of credit unions' considerations should be on educating the borrower on alternative products, if applicable.

A common theme among survey respondents was that member education is very important, as often the member will not understand the subtle differences between a PALs I and PALs III, for example, loan product. Therefore, a continued goal and possible parameter of a final PALs rule could include a financial education component or best practices, similar to the best practices section currently contained in PALs I.²

Other Considerations

It is central to note that existing small dollar loan programs at member credit unions are not being offered for their profitability, and instead they are offered primarily for the benefit of members, and are a mutually useful business strategy to develop and retain long-term relationships with members. However, the Association shares NCUA's concern as noted in the proposal over the overall low representation of credit unions using the existing PAL program, and offers the following considerations.

The location of a credit union and its primary membership-base is often a large factor in whether a payday lending program is successful and feasible. Credit unions with branches in communities with large populations of low to moderate income, military or immigrant households, or those in rural areas were few

² 12 CFR 701.21(c)(7)(iii)(B).

banking alternatives, often see greater demand for these types of products. As such, the Association recommends that the NCUA consider even greater flexibility for low-income designated credit unions and Community Development Financial Institutions (“CDFI”) credit unions.

In addition, long-term support from a credit union’s board and senior management cannot be overlooked as an important element for programmatic success. As such, NCUA could consider increased dialogue between the agency and credit unions interested in entering the small-dollar, short-term payday alternative marketplace. The results of such collaboration should be available to the industry by means of Q&As or other guidance, which could be used to educate staff, loan officers, boards, and senior management on the importance of a small-dollar loan product among the credit union’s many products and services.

PALs III

Should the agency move forward with a PALs III proposal, the Association proffers that states have long been innovative in this area. For example, Massachusetts holds the distinction of promulgating some of the strongest consumer protection laws, and has a longstanding small loan rate order.³ The state banking regulator examines specifically for payday-type loans. An analysis of other member states’ statutes and regulations reveals a wealth of information and history.⁴ For example, different state laws include deferment, prepayment and default clauses that may be useful features to an even further expanded payday alternative program. The Association therefore encourages NCUA to work closely with its colleague state regulators to implement any additional PALs rule.

Additionally, in January of 2017, the Office of the Comptroller of the Currency proposed the first Fintech Charter concept. Most recently the agency announced that it would move ahead to consider special-purpose charter applications from fintech firms. In the interim, one Association member federal credit union has moved ahead to collaborate on small dollar loan alternatives through a crowdfunding platform.⁵ The Association encourages NCUA to study these models to further enhance the attractiveness of the credit union not-for-profit charter and service to members.

The Association notes that the Federal Deposit Insurance Corporation (“FDIC”) undertook a two-year Small-Dollar Loan Pilot Program, which concluded in 2009. The pilot was a case study designed for banks to offer affordable small-dollar loans as an alternative to high-cost credit products such as payday loans.⁶ The Association raises this pilot and its associated results as another resource for NCUA to consider. The Association offers that such a pilot program may be a useful tool in considering a third PALs program, and could provide NCUA an opportunity with a smaller group of interested credit unions to explore how to increase credit union participation in a newer, flexible PALs program.

³ 209 CMR 26.01.

⁴ Delaware: 5 Del. C. §978, 5 Del. C. §2227 et seq., 5 Del. C. §2744; Massachusetts: MGL c. 140, s. 96-113, Small Loans Rate Order, 209 CMR 26.00 et seq.; New Hampshire: N.H. Rev. Stat. Ann. 399-A:1 et seq.; New Jersey: New Jersey Revised Statutes 17:15A-47; Rhode Island: 19-14.1-1 et seq., 19-14.4-1 et seq.

⁵ Digital Federal Credit Union, Marlborough, Massachusetts has collaborated with Axuda, a non-profit organization, to provide a crowd-lending forum for small, short-term interest free loans.

⁶ Pilot results are available at *A Template for Success: The FDIC’s Small-Dollar Loan Pilot Program*, FDIC Quarterly, 2010, Volume 4, No. 2, pp. 28-41, also available at <https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf>.

UDAAP Concerns

The Association raises the issue of the Bureau of Consumer Financial Protection's ("BCFP") regulation of Unfair, Deceptive, or Abusive Acts or Practices ("UDAAP") statutes, and in particular its Payday, Vehicle Title, and Certain High-Cost Installment Loans final rule ("payday rule"). NCUA in its proposal states that PALs II loans that utilize the proposed additional flexibilities of an increased maximum loan amount of \$2,000 and increased maximum loan maturity of 12 months will not qualify for a safe harbor or exemption under UDAAP. This is an insufficient response to the issue presented.

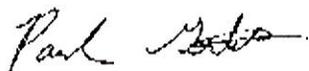
The Dodd-Frank Act added provisions allowing BCFP to restrict abusive acts under their UDAAP authority, and to write rules which identify such unfair, deceptive, or abusive acts or practices. Examination guidelines issued by BCFP also address UDAAP. In order for an act or practice to fall under the BCFP's UDAAP authority, BCFP must have a reasonable basis to conclude a service or product would harm a consumer, and the harm must outweigh the benefits to consumers or to competition.

It is unquestioned that PALs products do not meet this standard. Additionally, BCFP has expressly authorized and granted PALs products under the existing regulatory scheme an exemption from its payday rule. The current proposal, when finalized, should be given the same deference. BCFP should take comfort in the fact that this proposal was written, reviewed and proscribed by credit unions' primary regulator, it contains clear parameters, and offers best practices to avoid a rollover payday scenario.

The Association therefore urges NCUA to work with BCFP prior to issuing any final PALs II rule to develop a position that PALs products do not violate UDAAP and are exempt from the BCFP's payday rule. One approach could be that absent clear evidence showing that an NCUA payday loan rule violates UDAAP, or would allow federal credit unions to violate UDAAP, the authority of NCUA to charter and supervise federal credit unions, including payday loan components, should prevail without the need for separate exemptions every time NCUA amends its PALs program. It may be necessary, and the Association would support, a decision by NCUA not to name its products separately but rather to maintain a single PALs program that encompasses all available loan options in order to clarify any ambiguity relative to exemption.

Thank you for your consideration of these views. The Association appreciates the opportunity to provide input and I remain available to address any questions or concerns at pgentile@ccua.org that you or your staff may have at your convenience.

Sincerely,



Paul C. Gentile
President/CEO

PCG/kb/mabc