August 3, 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,

I am the T. Stevens Chair and Faculty Director of the Baugh Center for Entrepreneurship & Free Enterprise at Baylor University. I do research in the area of microcredit loans and have an interest in the impending legislation/regulation that impacts availability of capital for those living at or near the poverty line. I appreciate your considering my comments as NCUA considers changes to its program for small-dollar loans. Although this regulation is known as the Payday Alternative Loan program, I encourage NCUA to think broadly about small-dollar credit, as consumers choose between payday, auto title, pawn, rent-to-own, subprime installment, late fees, overdraft programs, and other forms of small credit that often substitute for one another.

As is demonstrated by the information published on the Payday Alternative Loan program, only roughly 1 in 6 federal credit unions offer these loans. Considering that fewer than 200,000 loans are issued annually in aggregate, the program is quite small. NCUA deserves kudos for trying to enable credit unions to compete in the small-loan market, but it is clear that credit unions have found that they cannot do so in a meaningful way under the current model. On a $500, 3-month loan, credit unions are permitted to charge just $44; on a $1,000, 5-month loan, just $91. These prices are certainly a good deal for the small minority of credit union members who can access them, but they have not led credit unions to choose to make these loans broadly available. Instead, without access to small loans from credit unions, members have been among the tens of millions of Americans who use high-cost loans from alternative financial services providers.

NCUA's proposal would let credit unions offer somewhat larger loans with somewhat longer terms, but it does not allow higher pricing than under the current program. It is unlikely that pricing which has not proved adequate to support this lending today will do so in the future because of changes to a maximum term and maximum amount. There has been a strong regulatory focus on requiring loans to show low Annual Percentage Rates (APRs). APRs are a comparison tool, but they make little sense as a regulatory device. If the $500, 3-month loan I mentioned above has a $20 application fee and $24 in interest charges, its APR is 28 percent. But if it has no application fee and $44 in interest charges, its APR is 52 percent. From a consumer's perspective, the cost is $44 either way.

Therefore, I urge NCUA to focus less on achieving a specific APR and instead on giving credit unions a way to create a better option for those who use high-cost loans today. I reside in Texas where payday lenders often charge $800-$1,300 in fees to borrow $500 for 6 months. Surely credit unions don't need to charge anywhere near that much, but just as surely, if they could be profitable making that loan for the $62 in gross revenue permitted by the current PAL program, they would do so.

Therefore, I urge NCUA to allow higher prices than the current 28 percent interest plus a $20 application fee. As an example, The Pew Charitable Trusts has proposed an 18 percent interest rate plus a monthly service fee up to $20. Such pricing would result in mid to high double-digit APRs, but it would also represent billions of dollars in annual savings if it displaced even a small share of the high-cost loan market. It would also allow more revenue for credit unions to invest in the technology needed to automate much of the lending process, bringing down costs in the long term.

I would also urge NCUA to allow credit unions to offer a line of credit option. For consumers with volatile incomes and expenses, a line of credit could easily be a better choice than a closed-end loan that has less flexibility. The prohibition on such flexible products under the current PAL program does a disservice to those households who see their incomes or expenses drop one month and spike the next.

For reference, I am including below a column I published on this topic several years ago. More competition for payday lending with banks and credit unions that have the scale and technology to assess risk and price accordingly and do this at a lower price that will work if freed up to do so. It will also diminish a two-tier system where the poor are excluded from banks/credit unions used by most consumers. If those who have been using payday services are in banks and see rates available for better credit and given advisement, it may give them knowledge of what is available if they continue to improve their credit situation. Thanks for your work on this important subject.

Steve Bradley

Sincerely,
Steve W. Bradley

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https://www.wacotrib.com/opinion/columns/guest_columns/steve-bradley-guest-columnist-loosening-restrictions-on-traditional-banks-is/article_824d0d51-62c0-5d0d-8a06-5815e35060a4.html

Steve Bradley, guest columnist: Loosening restrictions on traditional banks is sure start to reforming payday-lending practices

Feb 2, 2016

The Waco City Council is considering regulations on payday lenders that Dallas, Austin, Houston and other cities have enacted. Based on these cities' experiences, the ordinance would cause some but not all lenders to close. There isn't enough research to know whether this ordinance would benefit or harm borrowers, but that is crucial information for the Waco City Council to have.

Payday lenders are an easy target for criticism because their annualized interest rates are so high — usually more than 400 annual percentage rate in Texas. But our council should proceed with caution, taking care to avoid the kinds of mistakes described in “When Helping Hurts: How to Alleviate Poverty Without Hurting the Poor . . . and Yourself” and “Toxic Charity: How Churches and Charities Hurt Those They Help and How to Reverse It.” These award-winning books provide examples of how well-intentioned actions by government agencies, churches or nonprofits have often hurt the poor that they were trying to help.

Many studies have looked at states that eliminated payday lending to see how those bans affected borrowers and, overall, they’re inconclusive. Some studies found people were better able to pay their bills and buy food because they weren’t spending so much on payday loans; other studies found that people bounced more checks and used pawn shops more because payday loans weren’t available. Rather than eliminating payday loans, smart policy should seek to make lower-cost credit available without subsidies.

Research on the payday lending industry provides insights on how to achieve lower prices. Critics often contend payday lending is wildly profitable, but it’s not; the average profit margin of payday lenders is similar to that for other businesses. But the high interest rates are not caused by borrowers’ riskiness (even though they have low credit scores). Instead, two-thirds of the price of a payday loan goes to covering the expenses of running an inefficient business. The average payday loan store serves 500 unique borrowers per year. Even though Waco has many payday and auto title loan stores, most people do not borrow this way. Just 7 percent of adults in Texas use payday loans.

If loan prices are going to come down, lenders must become more efficient. That’s what happened in Colorado after a 2010 law change and now Coloradans have ready access to payday loans but at prices four times lower than those for Texans. Fifteen states have legislated payday lending out of existence by setting interest rates that were too low for lenders to stay in business. Colorado also insisted on lower prices but realistic ones. An average loan in Colorado is for $389 and is paid back in three months at a cost of $116. It’s not cheap, but that same loan in Texas costs more than $400 in fees. If the Waco City Council wants to help borrowers while keeping credit available when it’s needed, it should push the Texas Legislature to follow Colorado’s lead.

But there’s a way to bring the cost of credit down further than Colorado did; let lower-cost lenders with a comparative advantage into the market. Bank regulators like the Office of the Comptroller of the Currency can do this by allowing banks to offer small loans to their customers. Most banks have been prohibited from competing with payday lenders because bank regulators have insisted that they charge unrealistically low prices (just $24 for a $400, three-month loan) or go through an expensive underwriting process that would cause them to lose money. But recent research from The Pew Charitable Trusts has found that banks could profitably offer small loans at prices six times lower than payday lenders (about $50 for a $400, three-month loan) to the same people who use payday loans today.

Payday loan borrowers already have bank accounts and incomes (both are loan requirements), but they are going outside their banks when they need to borrow money. If the Consumer Financial Protection Bureau follows through on its proposal to allow a simple loan origination process like Colorado’s, with monthly payments at 5 percent of income, diversified banks could leverage their huge competitive advantages and quickly outcompete payday lenders.

For that to happen, we need well-designed rules like these to induce competition from efficient lenders like banks. That way loans to keep the utilities on, a car from being repossessed or food on the table till the next payday will be available, but on much better terms. The ordinance before the Waco City Council today won’t bring that about, but the council should push the Legislature and federal regulators for clear rules to give borrowers better options.