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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,

On behalf of Credit Human, 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. Addressing the needs of consumers who turn to payday lenders during a time of financial need falls within the specified credit union mission of "meeting the credit and savings needs of consumers, especially persons of modest means."

In 2015, Credit Human conducted research to better understand the utilization of payday lenders by our existing membership. Our research revealed that during a 5-month period (May-Sept. 2015), Credit Human members performed a total of 3,709 outgoing ACH transactions towards payday loan payments totaling $1,445,915. During the same period, there were 793 incoming ACH deposits from payday lenders totaling $552,740. Currently, there are 19 payday and alternative financial service providers within a one-mile radius from our headquarters. In our efforts to offer our membership a better and more affordable alternative, Credit Human began offering the PAL I product in April of 2017. We applaud NCUA's efforts to encourage credit union participation in an industry lacking lenders whose main goal is not to turn a profit, but to help consumers of modest means and we believe, with the NCUA's assistance, we can further address the needs of our members and potential members.

In the proposal, NCUA specifically requested comment on the need and demand for additional alternatives, as well as comment on whether to include some or all of the features of PALS II in PALS I. Further, NCUA specifically asked 11 questions regarding the possibility of a PALS III program. The subsequent page contains a summary of our recommendations followed by the detailed explanation of the recommendations.

**Summary**

| Provision | Current: PALs I | Proposed: PALs II | Recommendations: PALs II |
|---|---|---|---|
| Loan Amount | $200 - $1,000 | $0 - $2,000 | $0 - **$4,000** |
| Interest Rate | Up to 1,000 bps above max interest rate allowed by the NCUA (28%) | Up to 1,000 BP above max interest rate allowed by the NCUA (28%) | Up to **1,800 BP** above max interest rate allowed by the NCUA **(36%)** |
| Membership Requirement | Member for at least 1 month | No minimum | No minimum |
| Term | 1 - 6 months | 1 - 12 months | **1 - 36 months** |
| Application fee | Maximum $20 | Maximum $20 | **Maximum $50** |
| Limits on Usage | 3 PAL I loans in 6-month period and only one loan at a time | No limitation; only one loan at a time | No limitation; only one loan at a time |
| Structure | Closed-End | Closed-End | Closed-End & **Open-End** |
| Volume Limits | Aggregate of loans must not exceed 20% of net worth | Aggregate of loans must not exceed 20% of net worth | Aggregate of loans must not exceed 20% of net worth; **Exempt LICUs and CDFIs** |
| Other Restrictions | No Rollovers | No Rollovers | No Rollovers; **$50 Annual Participation Fee for Open End Loans; 5% Payment-to-Income Affordability** |

**PALs II Proposal**

We commend the Board's commitment to enhance the PALs product by expanding its parameters through the creation of the PAL II, and, we believe that if the Board developed principles rather than a product or product parameters, it would afford credit unions greater flexibility to design a product that meets the needs of its members. A principle-based approach allows for the inclusion of safeguards and features that are not offered by traditional payday lenders and that are not addressed within the current and proposed PAL program.

**Recommendation:** NCUA should consider developing principles and allowing credit unions to create a lending product that is competitive in the market and addresses the needs of our members and potential members. This approach would encourage credit union participation, incite innovation, and allow credit unions to meet the needs of their communities while preserving safety and soundness objectives.

Suggested principles:

- 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 payment history to the credit bureaus.

Should the lending product meet these principles, we recommend a credit union 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 46 days to 36 months;
3. Application fee does not exceed $50 for closed-end loans;
4. Annual participation fee does not exceed $50 for open-end loans;
5. Borrower has only one loan at a time;
6. Roll-overs are prohibited;
7. Closed-end loans amortize fully to $0;
8. Payments are no more than 5% of each gross paycheck or 6% of deposits in to accounts;
9. Loans repaid in substantially equal installment payments;
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 from this criteria.

**Comments on whether to include some or all of the features of PALs II in PALs I**
The model outlined in PALs II 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 only advantage of PALs I is the Bureau of Consumer Financial Protection (BCFP) safe harbor exemption from the "Payday, Vehicle Title, and Certain High-Cost Installment Loans" rule.

**Recommendation:** The BCFP's safe harbor is not a great enough advantage to sustain the PALs I product on its own, especially if it requires itemized reporting of PAL I and PAL II by the credit unions on the 5300 Call Report, which although not addressed in the proposal, is an area of concern for Credit Human. We recommend the consolidation of PAL I and PAL II. We further recommend the NCUA consider 2 components to the program: a closed-end version and an open-end version.

1) **Should the Board propose a third alternative PALS rule and why?**
We do not believe that PAL I and PAL II are enough to encourage credit unions to enter the payday alternative loan market, nor, it is enough to entice current PAL providers to make the investment necessary to scale up their programs. Credit unions need the flexibility to create a marketable product that not only promotes safety and soundness, but meets consumer demand.

**Recommendation:** Although we do not necessarily want three PAL products, we recommend NCUA propose a third a set of regulatory parameters, which provide flexibility to credit unions to create a PAL product that is marketable in their communities. 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.

We understand if NCUA decides not to finalize PALs II and instead proposes a third all-inclusive PALs program, there may have to be a second proposal and comment period, thus a delay in the final rule. We believe that providing credit unions with principles and broader regulatory parameters enabling them to create a PAL product which is beneficial to its members and encourages credit union participation a delay is worthwhile.

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?** In an effort for credit unions to be competitive in the payday alternative lending market, the current rate of 28% does not yield sufficient revenue for credit unions to invest in the automation and outreach necessary to promote and maintain a competitive and sustainable 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 1,800, allowing credit unions to offer a maximum APR of 36%. This rate is used in the *Military Lending Act* to restrict the prices charged to military members and their families; by 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 by many states for one or more of their consumer lending statutes. We believe raising the APR will encourage credit union participation in the program.

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 it is important for the viability of the program that application fee revenue be used to pay service providers, invest in loan processing automation and program technology, and promote the program so consumers use these loans rather than the high-cost loans currently offered by other lenders.

   **Recommendation:** The Board should consider increasing the 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 us 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 Human does not believe borrowers should be allowed more than one PAL loan at a time nor should we encourage recurring use or dependency 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?**
Twenty percent of net worth for Credit Human, a $3 billion institution, allows for substantial participation in the PALs Program. Twenty percent of net worth for smaller credit unions, though, may not be enough to encourage participation in PAL program, particularly those in low-income designated areas or those that participate in the Community Development Financial Institutions program.

   **Recommendation:** Credit unions having a low-income designation and credit unions participating in the Community Development Financial Institutions program should be exempt from the 20% net worth provision. This exemption is aligned with the existing exemption under Part §723.8 regarding Member Business Loans.

6) **Should the Board eliminate for PALs III the requirement that FCUs implement appropriate underwriting guidelines?**
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 credit union 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.

   **Recommendation:** 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 for a major emergency.

8) **Should the maturities for PALs III loans be longer than those permitted for other PALs loans?**
Members will require more than 12 months to repay at a payment that is both affordable and sustainable. Research conducted by the Pew Charitable Trust found that an average payday loan borrower can afford to spend roughly 5% of their gross income on loan payments. For an average borrower earning $30,000 per year, this equates to $125 per month. For such borrowers, 6 months is not long enough to repay $1,000 and 12 months is not long enough to repay $2,000.

**Recommendation:** We recommend that the Board allows terms up to 36 months.

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. Extensive research indicates 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 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. Another benefit of an open end loan product is the related participation fee, as opposed to a front ended application fee, which can be charged over the annual term of the loan making it more affordable for the consumer.

Credit unions should also be allowed, as permissible under Regulation Z, to charge a participation fee. If the maximum rate permitted is 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. If the Board allows credit unions the flexibility to charge up to 36% APR, as we recommended, 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?**

The CFPB's ability-to-repay requirements were focused on very high-cost loans because those loans pose great risk to consumers. Implementing this process would raise the cost of both origination and compliance. Additionally, we believe that an income-to payment limit would that ensure that the member can afford to make the payment. Research conducted by the Pew Charitable Trust found that an average payday loan borrower can afford to spend roughly 5% of their gross income on loan payments. For an average borrower earning $30,000 per year, this equates to $125 per month.

**Recommendation:** The loans envisioned under our recommendations for the PAL program would typically cost about six times less than payday loans, so they pose less risk to consumers. Each credit union should be allowed to implement their own underwriting guidelines and we recommend that the Board establish a payment-to-income limit of no more than 5% of each gross paycheck or 6% of deposits in to accounts. Using this threshold as a standard for affordable payments on PAL loans would help protect members while also providing a clear and easy-to-follow guideline that works well for credit unions.

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 serve as a better alternative for our members. Assessing 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 credit union account.

We thank you for 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 which will encourage credit union participation in PALs and further enable credit unions to meet their mission of serving members of modest means.

Sincerely,

Steve Hennigan, Member Since 1993
President/CEO