

7535-01-U

NATIONAL CREDIT UNION ADMINISTRATION

12 CFR Part 701

RIN 3133-AE84

Payday Alternative Loans

AGENCY: National Credit Union Administration (NCUA).

ACTION: Proposed Rule.

SUMMARY: The NCUA Board (the Board) is proposing to amend the NCUA's general lending rule to provide federal credit unions (FCUs) with an additional option to offer payday alternative loans (PALs). This proposal would *not* replace the current PALs rule (PALs I). Rather, it would be an alternative option, with different terms and conditions, for FCUs to offer PALs to their members. Specifically, this proposal (PALs II) would differ from PALs I by modifying the minimum and maximum amount of the loans, modifying the number of loans a member can receive in a rolling six-month period, eliminating the minimum membership requirement, and increasing the maximum maturity for these loans. The Board is proposing to incorporate all other requirements of PALs I into PALs II. The Board is also soliciting

comments from interested stakeholders on the possibility of creating a third PALs loan program (PALs III), which could include different fee structures, loan features, maturities, and loan amounts.

DATES: Comments must be received on or before [INSERT DATE 60 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER]

ADDRESSES: You may submit comments by any of the following methods (**Please send comments by one method only**):

- NCUA Web Site: http://www.ncua.gov/news/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include “[Your name] Comments on Notice of Proposed Rulemaking (PALs II)” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

Public inspection: All public comments are available on the agency’s website at <http://www.ncua.gov/RegulationsOpinionsLaws/comments> as submitted, except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in the NCUA’s law library, at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and

3:00 p.m. To make an appointment, call (703) 518-6540 or send an e-mail to
OGCMail@ncua.gov.

FOR FURTHER INFORMATION CONTACT: Martha Ninichuk, Director, Office of Credit Union Resources and Expansion; Matthew Biliouris, Director, Office of Consumer Financial Protection; or Justin M. Anderson, Senior Staff Attorney, Office of General Counsel, at the above address or telephone: (703) 518-1581 (Ms. Ninichuk), (703) 518-1140 (Mr. Biliouris), or (703) 518-6556 (Mr. Anderson).

SUPPLEMENTARY INFORMATION:

- I. Background**
- II. PALs II**
- III. Request for Comment - Additional Alternatives**
- IV. Regulatory Procedures**

I. Background

A. The PALs Rule and Payday Lending Industry

On September 16, 2010, the Board amended its general lending rule to enable FCUs to offer PALs loans as an alternative to predatory payday loans.¹ The Board intended to provide a regulatory framework so FCUs could be a viable alternative to high-cost payday lenders. The final rule permitted FCUs to charge a higher rate of interest for this type of loan if FCUs met certain conditions.

¹ 75 FR 58285 (Sept. 24, 2010). At the time, these loans were referred to as short-term, small amount loans.

The term “payday loan” generally refers to a short-term loan with a relatively small principal amount that is intended to cover a borrower’s expenses until his or her next payday, when the loan is to be repaid in full.² Historically, these loans often have been made by lenders who charge high fees and sometimes engage in predatory lending practices. While some payday loan borrowers use these loans sparingly, many other borrowers find themselves in cycles where their loans “roll over” repeatedly, incurring even higher fees. Often, these borrowers are unable to break free from an unhealthy dependence on payday loans. While data on payday lending is incomplete, the Consumer Financial Protection Bureau (CFPB) estimates that in 2015 the revenue for the traditional payday lending industry was \$3.6 billion and loan volume was approximately \$23.6 billion in new loans per year.³

B. PALs I

PALs I’s current regulatory framework permits an FCU to charge an interest rate for PALs loans that is 1000 basis points above the general interest rate set by the Board for non-PALs loans, provided the FCU is making a closed-end loan⁴ with the following conditions:

- (1) The principal of the loan is not less than \$200 or more than \$1000;

- (2) The loan has a minimum maturity term of one month and a maximum maturity term of six months;

² NCUA Letter to Federal Credit Unions, 09-FCU-05 (July 2009).

³ 81 FR 47863, 47870 (July 22, 2016).

⁴ 12 CFR § 1026.2(a)(10).

(3) The FCU does not make more than three PALs loans in any rolling six-month period to any one borrower and makes no more than one PALs loan at a time to a borrower;

(4) The FCU must not roll over any PALs loan. The prohibition against roll-overs, however, does not apply to an extension of the loan term within the maximum loan term permitted by the rule, provided the FCU does not charge any additional fees or extend any new credit.

(5) The FCU fully amortizes the loan;

(6) The FCU sets a minimum length of membership requirement of at least one month;

(7) The FCU charges an application fee to all members applying for a new loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20; and

(8) The FCU includes, in its written lending policies, a limit on the aggregate dollar amount of loans made under § 701.21(c)(7)(iii) of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.⁵

PALs I also includes a best practices section, which discusses topics to help ensure the product remains viable for the FCU and responsible for the borrower.⁶ The best practices section

⁵ 12 CFR § 701.21(c)(7)(iii).

⁶ Id. at § 701.21(c)(7)(iii)(B).

provides an FCU with guidance on implementing a PALs program, including: program features, underwriting, and risk avoidance.

C. 2012 Advanced Notice of Proposed Rulemaking (ANPR)

In the 2010 PALs I rulemaking, the Board indicated that, after one year, it would review the PALs loan data collected on the 5300 call reports and reevaluate the requirements of the rule.⁷ After conducting that review, the Board, at its September 2012 meeting, issued an ANPR seeking comments on specific aspects of PALs I, including the permissible application fee, interest rate, loan amounts, loan maturities, membership requirement, and the cap on the amount of loans made by an FCU. The Board also asked commenters to describe any payday alternative loan programs they were offering outside of PALs I.

In response, the Board received 27 comment letters from trade organizations, state credit union leagues, private citizens, consumer advocacy groups, a federal agency, lending networks, and FCUs. Generally, almost all of the commenters suggested at least one change to PALs I. There was, however, no general consensus among the commenters as to which aspects of the rule the Board should amend. The Board chose, at that time, not to undertake any changes to PALs I.

D. Evaluation of Data – Current Situation

On the December 31, 2017, 5300 call report, 518 FCUs reported offering PALs loans. They reported 190,723 outstanding loans with an aggregate balance of \$132.4 million. These figures represent a significant increase from 2012 when the Board issued the ANPR discussed above.

⁷ 75 FR 58285, 58288 (Sept. 24, 2010).

Based on the 2012 5300 call report, approximately 386 FCUs offered PALs loans, totaling 38,749 PALs loans with an aggregate outstanding balance of approximately \$13.5 million.⁸

E. Justification and Rationale

The Board has recently revisited PALs I and the trends in PALs loans data, as presented above. The data shows a significant increase in the total dollar amount of PALs loans outstanding, but only a modest increase in the number of FCUs offering these loans. The Board wants to ensure that all FCUs that are interested in offering PALs loans are able to do so. The terms of PALs II loans are more flexible and the product is potentially more profitable for FCUs, which should increase interest. The Board notes that PALs II would not replace PALs I. Rather, PALs II would be an additional option FCUs could choose in making PALs loans to their members. An FCU could choose to make PALs I loans, PALs II loans, or both.

II. Proposed Rule

As noted above, PALs II will incorporate many of the features of PALs I, but will provide additional flexibility for FCUs in the areas of loan amount, membership requirement, loan term, and number of loans permitted. The Board notes, however, that PALs I loans and PALs II loans are distinct products that must satisfy all of the regulatory conditions applicable to the particular type of loan in order to be classified as such. For example, a \$300 loan with a six-month maturity made to a person who has been a member for two-weeks is a PALs II loan because it meets all of the requirements for a PALs II loan, but it is not a PALs I loan because it does not meet the membership requirement of PALs I. As discussed below, this distinction is critical as it

⁸ Id. at 2447 (May 5, 2010).

has implications for compliance with the CFPB's regulations. Of course, a loan that does not satisfy all of the conditions of either PALs I or PALs II is neither a PALs I nor a PALs II loan.

A. Features Incorporated from PALs I

The Board is proposing to incorporate the following features from PALs I into PALs II. These features achieve a balance between consumer protection and safety and soundness for FCUs.

1. **Permissible interest rate.** The permissible interest rate for a loan under PALs II will be 1000 basis points above the established general interest rate ceiling, as set by the Board.
2. **Loan structure.** A PALs II loan must be a closed-end loan.
3. **Permissible fees.** An FCU may charge an application fee, provided it charges the fee to all members applying for a new loan and the fee reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20.
4. **Rollovers.** An FCU may not roll over any PALs II loan, but it may extend the loan term up to the maximum 12 months permitted by the rule, if the loan was made with a lesser loan term, provided the FCU does not charge any additional fees or extend any new credit.
5. **Aggregate lending cap.** An FCU making PALs II loans must include in its written lending policies a limit on the aggregate dollar amount of loans made under this program of a maximum of 20% of net worth and implement appropriate underwriting guidelines to minimize risk.

6. **Amortization.** An FCU must amortize all PALs II loans and may not include balloon payments.

B. Features Unique to PALs II

For the reasons discussed in each of the subsections below, the Board is proposing PALs II with certain features different from PALs I. The Board believes the different features in PALs II will encourage additional FCUs to offer PALs II loans as an alternative to predatory payday loans. In addition, these different features will help FCUs meet the specific demands of certain payday loan borrowers that may not be met by PALs I and provide borrowers with a safer, less expensive alternative to traditional payday loans.

1. **Loan Amount.** The Board is proposing to permit PALs II loans in amounts up to \$2,000, which is significantly higher than PALs I loans. Also, PALs II would eliminate the minimum loan amount that is part of the PALs I program. The Board believes a higher maximum and no minimum loan amount will allow FCUs to better meet the demands of payday loan borrowers. Further, a higher loan amount may allow some borrowers to consolidate high-priced, traditional payday loans into one less expensive, consumer friendly PALs II loan.
2. **Loan Term.** Corresponding to the increase in permissible loan amount, the Board is proposing a maximum loan term of 12 months. This differs from the six-month maximum loan term for PALs I, and is directly correlated to the requirement that FCUs amortize PALs loans and the proposed higher PALs II loan limit. PALs II

loans would retain the PALs I minimum term of one month to ensure borrowers have sufficient time to repay their loans and are not subjected to the typical two-week repayment period imposed by most traditional payday lenders. The Board notes that FCUs would be free to choose an appropriate loan term, provided the loan fully amortizes, but encourages FCUs to select loan terms that are in the best financial interests of borrowers.

- 3. Membership Requirement.** The Board is proposing to impose no minimum length of membership requirement for a PALs II loan. Conversely, under PALs I, an FCU must set a minimum length of membership requirement of at least one month before lending to a borrower. The Board included the membership requirement in PALs I as a safety measure for FCUs. As noted in the final PALs I rule, the Board believed a minimum membership requirement of one month would build a meaningful relationship between the borrower and the FCU and help reduce the chance of a borrower defaulting on a PALs I loan.⁹ While the Board still encourages FCUs to consider a minimum membership requirement, the Board wants to provide FCUs with maximum flexibility to reach as many potential borrowers as possible in a safe and sound manner. Accordingly, PALs II does not impose a minimum length of membership requirement. Allowing FCUs to make loans without a minimum length of membership requirement will permit FCUs to assess their own risk tolerances and make loans to payday loan borrowers who need access to funds immediately and would otherwise turn to traditional payday lenders

⁹ 75 FR 58285, 58288 (Sept. 24, 2010).

to meet that need. The Board reminds FCUs, however, that all borrowers must be members of the credit union, regardless of a length of membership requirement.

4. **Number of Loans.** The Board proposes no requirement in PALs II limiting an FCU to making only three PALs loans to a member in a rolling six-month period. This limitation is applicable to PALs I loans and permits FCUs to make one loan at a time to a particular borrower and no more than three in any rolling six-month period to that borrower. The Board proposes to remove the rolling six-month requirement for PALs II to provide maximum flexibility to FCUs to help meet the demand of borrowers in a safe and sound manner. Under this proposal, FCUs would still only be permitted to make one loan at a time to any one borrower, but would be able to make additional loans to that borrower with no time restrictions provided there is only one loan outstanding at a time to that borrower. The Board believes this will better enable FCUs to meet the demands of those borrowers who take out very small loans, repay them rapidly, and need additional loans within a six-month period.

The Board is proposing to create a new subsection in § 701.21(c)(7) that will contain the regulatory text for PALs II. The Board notes that the best practices and guidance that is applicable to the current PALs rule will also apply to PALs II.

C. Compliance with the CFPB’s Payday, Vehicle Title, and Certain High-Cost Installment Loans Rule (Payday Loan Rule).

On November 17, 2017, the CFPB passed its Payday Loan Rule, which, among other things, establishes consumer protections for certain credit products and deems certain practices to be abusive and unfair.¹⁰ These abusive and unfair practices include: (1) failing to reasonably determine that consumers have the ability to repay a loan according to its terms; and (2) attempting to withdraw payments from a consumer’s account after two consecutive payments attempts have failed. The Payday Loan Rule also includes registration and record retention requirements.

The Payday Loan Rule provides a “safe harbor” for any loan that is made by an FCU in compliance with all of the requirements in 12 CFR § 701.21(c)(7)(iii), thereby fully exempting those loans from compliance with the Payday Loan Rule.¹¹ The Board strongly supported the safe harbor for PAL loans made by FCUs and applauds the CFPB for recognizing that PALs loans made in conformity with 12 CFR § 701.21(c)(7)(iii) of the NCUA’s regulations are a responsible, safe, and non-abusive alternative to most traditional payday loans. Accordingly, so that FCUs may continue to avail themselves of the safe harbor from the Payday Loan Rule, the Board will maintain the current PALs rule unchanged, as PALs I.

To provide additional flexibility to FCUs, however, the Board is proposing PALs II as an additional option to serve members’ needs in the payday lending space. The Board recognizes that PALs II loans will not qualify for the safe harbor from the CFPB’s Payday Loan Rule.

¹⁰ 82 FR 54472 (Nov. 17, 2017).

¹¹ *Id.* at 54548.

However, in the Payday Loan Rule, the CFPB also provided a partial exemption for “alternative loans.” The CFPB defines “alternative loans” as those loans that meet all of the requirements of the NCUA’s current PALs rule, except that lenders are not required to have a minimum membership requirement or a limit on the number of loans they can provide to any one borrower in a six-month period.

While PALs II loans, therefore, will not qualify for the safe harbor, these loans can qualify for the alternative loans exemption under particular conditions. Specifically, to qualify as an “alternative loan” a PALs II loan must meet all of the requirements of PALs I, except FCUs are not required to have a minimum membership requirement or a restriction on the number of loans provided to a borrower in a six-month period. The Board believes this proposed change will provide FCUs with additional flexibilities while retaining a partial exemption from the CFPB’s Payday Loan Rule.

In addition, the Board is also proposing to authorize additional flexibility in PALs II by raising the maximum amount of a permissible loan to \$2,000 and increasing the maximum maturity to 12 months. PALs II loans that utilize these additional flexibilities, however, will not qualify for either the safe harbor or the exemption for “alternative loans.” The Board believes these additional flexibilities will allow an FCU to make a business decision in crafting a PALs program that takes into account the needs of its members and its ability to comply with the CFPB’s Payday Loan Rule.

III. Request for Comment - Additional Alternatives

While the terms of PALs II in this proposal would provide FCUs with additional flexibility to meet the demands of borrowers, the Board is considering issuing an additional alternative PALs rule in the future. Before proposing any additional alternatives, however, the Board requests comment on the need and demand for additional alternatives.

Specifically, the Board s requests comment on whether to include some or all of the features of PALs II in PALs I. This option would make PALs I more flexible, but also would eliminate FCUs' safe harbor from the CFPB's Payday Loan Rule.

Also, the Board is considering creating an additional kind of PALs rule, defined as PALs III, which would be even more flexible than PALs II. Before proposing PALs III, however, the Board requests comment on whether there is demand for such a product, as well as what features and loan structures could be included in PALs III. The Board notes, however, that along with the flexibility of additional features in PALs III, FCUs would be subject to all aspects of the CFPB's Payday Loan Rule.

The Board poses the specific questions below for comment, but invites stakeholders to provide input of any kind on any aspect of a potential PALs III rule.

1. Should the Board propose a third alternative PALs rule and why?
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?

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?
4. Should the Board allow FCUs to make more than one kind of PALs loan at a time to a borrower?
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?
6. Should the Board eliminate for PALs III the requirement that FCUs implement appropriate underwriting guidelines?
7. Should the Board set for PALs III the maximum loan amount above that permitted for other PALs loans?
8. Should the maturities for PALs III loans be longer than those permitted for other PALs loans?
9. Should the Board permit PALs III to include an open-end loan product?
 - a. If the Board permits an open-end product,¹² should the Board allow FCUs to charge participation fees, provided the fees are not considered a finance charge under Regulation Z?¹³
 - 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?
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?

¹² 12 CFR § 1026.2(a)(20).

¹³ Id. at § 1026.4.

11. Should the Board prohibit FCUs from charging overdraft fees for PALs loan payments drawn against a member's account?

IV. REGULATORY PROCEDURES

Regulatory Flexibility Act

The Regulatory Flexibility Act requires the NCUA to prepare an analysis to describe any significant economic impact a rule may have on a substantial number of small credit unions (those under \$100 million in assets). This proposal would provide a limited number of FCUs making PALs loans with additional flexibility to make such loans. The rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

Paperwork Reduction Act

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501, *et seq.*) (PRA), the NCUA may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget (OMB) control number. For purposes of the PRA, an information collection may take the form of a reporting, recordkeeping, or a third-party disclosure requirement, referred to as a paperwork burden. The information collection requirements of § 701.21 of NCUA's regulations are assigned OMB control number 3133-0092 and this proposed rule would not impose any new burden.

Executive Order 13132

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order. The proposed rule would not have substantial direct effects on the states, on the connection between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

The Treasury and General Government Appropriations Act, 1999 - Assessment of Federal Regulations and Policies on Families

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

List of Subjects in

12 CFR part 701

Credit unions, Federal credit unions

By the National Credit Union Administration Board on May 24, 2018.

Gerard Poliquin
Secretary of the Board

For the reasons discussed above, the National Credit Union Administration proposes to amend 12 CFR § 701.21 as set forth below:

PART 701 – ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

1. The authority citation for part 701 continues to read as follows:

Authority: 12 U.S.C. 1752(5), 1755, 1756, 1757, 1759, 1761a, 1761b, 766, 1767, 1782, 1784, 1787, 1789. Section 701.6 is also authorized by 15 U.S.C. 3717. Section 701.31 is also authorized by 15 U.S.C. 1601 et seq.; 42 U.S.C. 1981 and 3601–3610. Section 701.35 is also authorized by 42 U.S.C. 4311–4312.

2. In section 701.21(c)(7), revise paragraph (c)(7)(iii) as follows:

§ 701.21 Loans to members and lines of credit to members

* * * * *

(iii) *Payday alternative loans I (PALs I).*

* * *

(g) The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of PALs I and PALs II loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

* * *

(B) PALs I Loan Program guidance and best practices. In developing a successful PALs I loan program, a Federal credit union should consider how the program will help benefit a member's financial well-being while considering the higher degree of risk associated with this type of lending. The guidance and best practices are intended to help Federal credit unions minimize risk and develop a successful program, but are not an exhaustive checklist and do not guarantee a successful program with a low degree of risk.

(i) Program features. Several features that may increase the success of a PALs I loan program and enhance member benefit include adding a savings component, financial education, reporting of members' payment of PALs I loans to credit bureaus, or electronic loan transactions as part of a PALs I program. In addition, although a Federal credit union cannot require members to authorize a payroll deduction, a Federal credit union should encourage or incentivize members to utilize payroll deduction.

(ii) Underwriting. Federal credit unions need to develop minimum underwriting standards that account for a member's need for quickly available funds, while adhering to principles of responsible lending. Underwriting standards should address required documentation for proof of employment or income, including at least two recent paycheck stubs. Federal credit unions should be able to use a borrower's proof of recurring income as the key criterion in developing standards for maturity lengths and loan amounts so a borrower can

manage repayment of the loan. For members with established accounts, Federal credit unions should only need to review a member's account records and proof of recurring income or employment.

(iii) Risk avoidance. Federal credit unions need to consider risk avoidance strategies, including: requiring members to participate in direct deposit and conducting a thorough evaluation of the Federal credit union's resources and ability to engage in a PALs I loan program.

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3. In section 701.21(c)(7) after paragraph (c)(7)(iii) add new paragraph (c)(7)(iv) to read as follows:

§ 701.21 Loans to members and lines of credit to members

* * * * *

(iv) Payday alternative loans II (PALs II). Notwithstanding the provisions in §701.21(c)(7)(ii), a Federal credit union may charge an interest rate of 1000 basis points above the maximum interest rate as established by the Board, provided the Federal credit union is making a closed-end loan in accordance with the following conditions:

(1) The principal of the loan is not more than \$2000;

(2) The loan has a minimum maturity term of one month and a maximum maturity term of twelve months;

(3) The Federal credit union does not make more than one PALs loan at a time to a borrower;

(4) The Federal credit union must not roll-over any PALs II loan;

(A) The prohibition against roll-overs does not apply to an extension of the loan term within the maximum loan terms in paragraph (c)(7)(iv)(2)(j)(1)(ii) provided the Federal credit union does not charge any additional fees or extend any new credit.

(B) [Reserved]

(5) The Federal credit union fully amortizes the loan;

(6) The Federal credit union charges an application fee to all members applying for a new loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20; and

(7) The Federal credit union includes, in its written lending policies, a limit on the aggregate dollar amount of PALs I and PALs II loans made under this section of a maximum of 20% of net worth and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

(B) PALs II Loan Program guidance and best practices. The PALs II loan program guidance and best practices are the same as those outlined for PALs I in §701.21(c)(7)(iii)(B).