COMMENTS of

NATIONAL CONSUMER LAW CENTER (on behalf of its low-income clients)
and
CONSUMERS UNION

on the
National Credit Union Administration's Proposed Rule on
Short-Term, Small Amount Loans
12 CFR Part 701
75 Fed. Reg. 24497 (2010)

July 6, 2010

The National Consumer Law Center, on behalf of its low income clients, and Consumers Union, nonprofit publisher of Consumer Reports, submit these comments in response to the National Credit Union Administration's request for comments on its proposed rule on Short-Term, Small Amount Loans.

SUMMARY

We appreciate NCUA's efforts to promote affordable, responsible lending to consumers who are currently turning to payday lenders to meet their credit needs. We welcome the opportunity to comment on the proposed rule. Before turning to the proposal, however, we note that the most important steps that NCUA can take to encourage responsible small dollar lending are outside of the proposed rule.

NCUA's initial task must be to address triple-digit payday lending by credit unions that are evading their legal usury caps. As detailed in the National Consumer Law Center's recent report, *Stopping the Payday Loan Trap: Alternatives that Work, Ones that Don't,*[1] many federal and state credit unions are offering short-term loans with true rates above 18%, up to 400% or even higher. NCUA has a variety of legal tools to address these evasions, including authority under the Truth in Lending Act, Federal Credit Union Act, Federal Trade Commission Act, and its safety and soundness responsibilities stemming from NCUA's role as an insurer of federal and state credit unions. Credit unions that are not offering affordable small dollar loans today will have little reason to do so under the proposed rules if they can charge more under existing rules.

NCUA should also do more to promote wide availability of reasonably-priced lines of credit to payday borrowers under existing rules. NCUA should encourage credit unions to offer responsible lines of credit instead of fee-based overdraft programs. NCUA should also issue rules to rein in improper practices used by credit unions to increase overdraft fees, including ensuring that fees are reasonable and proportional to the overdraft, limiting the number of overdraft fees, prohibiting high-to-low check or

[1] The report is available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

debit reordering, and requiring clear disclosure of all overdraft options before seeking opt-ins to fee-based programs.

With respect to the proposal, we support a higher 28% interest rate cap for small dollar loans but with the following changes to the proposed rule:

- Only one $20 application fee should be permitted per year, or at most every six months.
- No other fees, including late or other penalty fees, should be permitted.
- The minimum term should be 90 days, or one month per $100 borrowed for loans under $300.
- Loans at the 28% rate must be repaid in multiple, fully amortizing installment payments.
- Loans at the 28% rate should not be secured by mandatory electronic repayment or other electronic security, nor require payroll deduction. A direct deposit requirement, without mandated electronic repayment, is acceptable.

Open-end lines of credit should be permitted to utilize the higher rate as long as they meet the same criteria. We also support an alternative of a 36% rate (for open-end or closed- end loans) on the same terms as above but *with no fees whatsoever*. A fee-inclusive APR is unworkable under current Truth in Lending Act regulations.

NCUA should collect data on loans made under the new rules (and also under existing rules) and should analyze the data and publicize the results in order to further refine which types of loans are sustainable for both credit unions and consumers.

I. NCUA'S FIRST TASK MUST BE TO AVOID EVASIONS OF EXISTING FEDERAL AND STATE USURY CAPS.

NCUA's first and most important step must be to ensure that credit unions are complying with the letter and spirit of *current* laws and are not offering predatory loans. A surprising and growing number of federal and state credit unions are offering triple-digit payday loans. Credit unions that have been reluctant to offer affordable small loans under current rules will have little incentive to do so under the proposed rules if they can make more money by exploiting loopholes in the current regulatory structure.

A. Credit Unions Offering Triple-Digit Payday Loans.

Several federal credit unions are offering short-term loans that have a true APR far above 18%.[2] Kinecta Federal Credit Union offers payday loans through locations within its Nix Check Cashing subsidiary. Kinecta is the lender. Kinecta charges a

[2] *See* National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives That Work, Ones That Don't* at 26-27, Appendix A-3 at 37-43 (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf (detailing these loans) (hereinafter *Stopping the Payday Loan Trap*).

$39.95 application fee, on top of 15% annual interest, for each of its standard $400 14-day loans. The application fee is charged each time, even for repeat borrowers and rollover loans. With fees included, the true APR is 362%. Clearly, the credit union is collecting most of its profit through the $39.95 "application" fee, not the $2.30 interest generated over 14 days.[3]

Many other federal credit unions make triple-digit loans available to their members but do not make the loans directly. Instead, they apparently take a broker's or finder's fee on payday loans made by third-party credit union service organizations (CUSOs). Sometimes these loans are offered on the credit union's website with a link to the CUSO site. In at least one case (America First Credit Union in Utah) and possibly others, federal credit unions are facilitating these triple-digit loans by directing consumers to terminals in their own lobbies. In all cases, the FCU's name is associated with the loan.

The CUSO CU Access offers purportedly open-end lines of credit[4] to credit union members, charging a $20 monthly fee and 18% annual interest on extensions of credit that are due in 30 days. With fees included, the true APR of a $300 loan is approximately 99%. The monthly fee was lowered from $59 after NCLC's *Stopping the Payday Loan Trap* was released. The following federal credit unions are listed on the CUSO's website (www.e-accessloan.com) as participating in their program:

Pinal County Federal Credit Union	AZ
Univ. of Hawaii Federal Credit Union	HI
Crossroads Financial Federal Credit Union	IN
LAMPCO Federal Credit Union	IN
County Federal Credit Union	ME
Community One Federal Credit Union	NV
Huntington County Federal Credit Union	PA
Heritage Trust Federal Credit Union	SC
Chemcel Federal Credit Union	TX
Gulf Coast Federal Credit Union	TX
Pocahy Family Express Cash	TX
The Local Federal Credit Union	TX
Tip O'Texas Federal Credit Union	TX
Alliance Credit Union	UT
America First Credit Union	UT
Family First Federal Credit Union	UT

[3] Nevada Federal Credit Union was engaged in similar manipulations, putting the entire cost of its loans into an "application" fee and charging no interest, until apparently stopped by regulators.
[4] A loan that is due in full in 30 days is arguably not an open-end loan.

A few state credit unions also offer loans through CU Access, with the same disclosed APR of 18% for triple-digit loans.

CU on Payday, another CUSO, offers payday loans to members of both federal and state credit unions on terms that vary by state. For most of the federal credit unions that participate, the terms are $12 per $100 for a closed-end loan due the next payday. The CU on Payday website discloses an honest APR of 292% for a 15-day $300 loan to members of federal credit unions. Loans to members of Chetco Federal Credit Union in Oregon are for 31 days, with an APR of 141% for a $300 loan. According to the CUSO's website (www.CUonPayday.com), loans are available to members of the following federal credit unions:

Chetco Federal Credit Union	OR
Northern Hills Federal Credit Union	OR
Cyprus Credit Union Payday Loan	UT
Heritage West Credit Union Payday Loan	UT
Southwest Federal Credit Union	UT
USU Charter Credit Union	UT
People's Community Federal Credit Union	WA

Many state credit unions, including some bound by state usury caps that compare to the 18% federal cap, also offer triple-digit loans through CU Access, CU on Payday or other CUSOs.[5]

B. Legal Issues Raised by Usury Rate Evasions.

Federal and state credit unions that are involved in triple-digit lending despite usury caps do so primarily in one of two ways (or both). First, they may put the bulk of their charges into application or participation fees that they claim are excluded from the finance charge used to calculate the annual percentage rate under Truth in Lending Act (TILA) regulations. Second, the credit union may not be the actual lender, but instead the credit union takes a finder's or broker's fee for loans made by a CUSO that would be illegal for the credit union to make directly.

In either case, NCUA has a variety of legal tools to stop these evasions. A detailed legal analysis can be found in the National Consumer Law Center's January 27, 2009 letter to NCUA.[6] In brief, the legal issues include:

- *TILA*: As outlined in the 2009 NCLC letter, labeling a fee an "application" or "participation" fee does not always mean that the fee can be excluded from the APR under the Federal Reserve Board's existing TILA regulations. Credit unions

[5] *See* NCLC, *Stopping the Payday Loan Trap*, Appendix A-3 at 37-43.
[6] The letter is available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf.

that charge fees that dwarf the finance charges and are intended to cover more than the cost of opening the account violate TILA.[7] Though NCUA does not write the TILA regulations, it does issue guidance and conduct examinations for TILA compliance. NCUA inform credit unions of its view that application or participation fees charged more than once a year that exceed the finance charges do not comply with TILA if they are excluded from the finance charge.

- *Federal Credit Union Act (FCUA)*:

    - *Usury cap.* NCUA's authority to interpret and enforce the usury cap in the Federal Credit Union Act is independent of TILA and Federal Reserve Board (FRB) interpretations of the TILA APR. NCUA should issue a regulation making clear that it violates the FCUA for a credit union to evade the usury cap by charging an application or participation fee that exceeds the finance charge. Note that such a regulation would not require NCUA to stray from the FRB's methodology for calculating or disclosing the APR. NCUA would merely be restricting the application and participation fees that a federal credit union may charge in order to avoid evasions of the FCUA's usury cap.

    - *Finder's or Broker's Fees.* NCUA has authority under the FCUA to determine the circumstances under which a FCU can charge a finder's or broker's fee. NCUA should issue a regulation prohibiting a FCU from collecting a fee on a loan that would be illegal for the FCU to make.

    - *Investment in CUSOs.* Under existing NCUA regulations, FCUs may not invest in CUSOs that do payday lending. NCUA should investigate the ownership of all payday CUSOs to ensure that no FCUs are violating that rule. According to press reports, America First Credit Union, a federal credit union, is part owner of a payday lending CUSO.

- *FTC Act UDAP authority*: With respect to both federal and state credit unions, NCUA should use its authority to prevent unfair or deceptive acts or practices to direct credit unions not to structure their loans in such a way as to evade interest rate caps. Any loan structured to have fees that routinely exceed the finance charges, and more than double the disclosed APR, is unfair and deceptive. In addition, it is unfair and deceptive for a credit union to lend its name, website or terminals in its lobby in connection with a loan that is not actually made by the credit union and would be illegal for the credit union to make. A mere disclosure that the credit union is not the lender is not sufficient to remove the credit union's association with the loan.

[7] Beyond looking at what costs the application or participation fee cover, NCUA should also examine the loan structure from the other direction: is the periodic interest enough to cover the costs of credit, loan losses, and other costs that are expected to be borne by the finance charge? If not, then the application or participation fee is covering those costs and should be considered a finance charge.

- *Safety and soundness risks, including reputational risk.* In its capacity as insurer of both federal and state credit unions, NCUA should inform credit unions of the risks of involvement in payday lending and of the supervision that credit unions should expect if they are involved in such lending. As detailed in the 2009 NCLC letter, NCUA has a number of tools under its safety and soundness authority, and should also remind credit unions that the risks of predatory lending are not obviated and may be increased if the lending is done through third parties.

- *Preemption.* NCUA should remind federal credit unions that subsidiaries such as CUSOs do not enjoy preemption of state laws under NCUA regulations. NCUA should also instruct FCUs that, even when they can ignore state laws, it poses a significant risk to the credit union's reputation to ignore state limits on small loans and to make loans that would be illegal for other lenders in the state.

Before it raises the interest rates that federal credit unions can charge for small loans, NCUA must ensure compliance with its current lending rules.

II. NCUA SHOULD ENCOURAGE CREDIT UNIONS TO MORE WIDELY OFFER REASONABLY-PRICED LINES OF CREDIT TO PAYDAY BORROWERS.

A. Credit Unions Should Offer Reasonably Priced Lines of Credit Instead of Fee-Based Overdraft Programs.

NCUA could do more to help payday borrowers by promoting low-cost overdraft protection under current rules for those who have imperfect credit than by increasing rates for closed end loans. Many credit unions, like many banks, have instead chosen to adopt fee-based overdraft programs that are designed more to pad credit union profits than to serve their members. With the new Regulation E changes that require consumers to opt in to fee-based overdraft programs covering ATM or debit cards,[8] NCUA has an opportunity to steer credit unions away from programs aimed at increasing overdraft fees and towards true overdraft protection.

Moreover, credit union members turn to payday loans in part because they do not have access to reasonable overdraft protection or have been trapped in fee-based overdraft programs. A reasonably priced line of credit can both avoid the overdraft fees that drive some consumers to take out payday loans and also serve as an independent source of credit.

The lines of credit that credit unions traditionally offer may not be available to the credit-impaired customers, or those with thin or no credit files, who typically take out payday loans. But if credit unions are willing to give those consumers a hidden line of credit through their fee-based overdraft programs, they should be able to develop a reasonably-priced small line of credit that fits this population. These lines of credit

[8] 74 Fed. Reg. 59033 (Nov. 17, 2009).

would serve these customers well even if they were much smaller than the standard ones, perhaps as low as $200. It is also important to ensure that credit unions do not add high participation fees that add substantially to the interest rate.

B. NCUA Should Issue Rules on Fee-Based Overdraft Programs.

NCUA should also adopt rules to address improper practices under fee-based overdraft programs. As described in NCLC's *Stopping the Payday Loan Trap*,[9] payday lenders have some justification for claiming that their loans are cheaper than overdraft fees, at least in the short term. Many credit unions have been just as complicit as banks in pushing consumers into expensive fee-based overdraft programs that are designed to increase fees and profits, not help consumers.

Compliance with the new Regulation E overdraft rules is not sufficient to protect consumers from bank and credit union programs designed to increase overdraft fees. As we detailed in our recent comments to the Office of Thrift Supervision,[10] NCUA should:

- ensure that overdraft fees are reasonable and proportional by (1) requiring that fees bear some relationship to the lower of the amount of credit extended or the cost to the thrift of covering the overdraft, (2) limiting the number of fees a credit union can charge before offering a more suitable alternative, and (3) banning sustained overdraft fees;

- declare the re-ordering of transactions from largest to smallest—a practice designed to maximize overdraft fees—an unfair trade practice;

- require credit unions to disclose the availability and cost of all of their overdraft programs in an easy-to-understand format, and allow consumers the choice whether to opt-in to *any* type of overdraft payment method, including checks and electronic payments that are not currently covered by Regulation E.

Addressing the widespread pernicious features of credit-union fee-based overdraft programs will do more to help consumers than creating a handful of new small loan programs.

III. THE PROPOSED RULE SHOULD BE REVISED TO ENSURE THAT LOANS WILL BE RESPONSIBLE AND AFFORDABLE.

A. No More Than One, Or At Most Two, Application Fees per Year.

---

[9] *See Stopping the Payday Loan Trap* at 28-29.
[10] The comments are available at http://www.nclc.org/images/pdf/banking_and_payment_systems/comment-ots-overdraft-guidance-2010.pdf.

The proposed rules permit credit unions to charge a $20 application fee on top of 28% interest. Loans can be as short as 30 days, and credit unions can extend up to six loans – and charge six $20 fees – to the same borrower in a year (but no more than three over six months). Though the proposed rules prohibit rollovers, there is little to prevent a borrower from repaying a loan and taking out a new one a day or a week later. Indeed, credit unions might even be able to follow the common practice of payday lenders, in states that prohibit rollovers, of accepting payoff of the first loan and handing the money right back as a new loan on the spot.

For lenders who charge the higher 28% rate, no more than one $20 application fee per year, or at most two (one every six months), should be permitted. Among the better payday loan alternatives identified in *Stopping the Payday Loan Debt Trap*, most had no application or annual fee or charged fees in the range of $20 to $40 total per year.[11]

A 30-day, $300 loan at 28% with a $20 application fee taken off the top yields **a true APR with fees of 116%**. The $20 fee far exceeds the $6.90 in interest generated over 30 days, or even the $13.80 charged over 60 days. It is one thing if that fee is charged only once, and the effective rate goes down if the consumer takes out subsequent loans. But the rate stays the same if the fee is charged each time. The proposed rules permit as much as $120 in fees per year, far more than justified by application costs. Permitting more than one $20 fee every six months will undermine the 28% rate and result in a true rate substantially higher than 36%.

After the first loan, the cost to the lender of underwriting new loans to the same borrower is much lower and the same fee is not justified. Though the proposed rule also states that the application fee cannot exceed the actual costs associated with processing the application, this is a difficult requirement to enforce. Even if the credit union can justify repeat fees from a cost perspective, multiple fees are harmful to consumers and result in high-cost lending far in excess of the 15% cap permitted by statute.

Permitting multiple application fees encourages lenders to offer shorter term loans, so that loan renewals will generate more fees. This is exactly the reverse of the incentive that lenders should have: to make longer-term, more affordable loans that do not encourage repeat borrowing or multiplying fees.

For NCUA to sanction a new application fee for each 30-day loan – even if capped at three every six months – would take credit union lending in exactly the wrong direction.

B. All Other Fees, Including Late Fees, Should Be Prohibited.

The proposed rule caps the application fee but does not prohibit other fees. To ensure that the loans are consistent with the intention that the application fee be the only

[11] *See Stopping the Payday Loan Trap*, Appendix A-1 at 30-34.

fee – and that fees not otherwise pad the 28% rate – the rule needs to explicitly ban other fees, including late fees.

Lenders have been creative in coming up with a multitude of new fees. For examples, fee-harvester credit cards marketed to those with poor credit often charge "processing," "activation," or "setup" fees. Though these fees are likely to be considered finance charges for closed-end loans, which must be contained within the 28% rate, the rules should eliminate any possibility of confusion or new creative fees by simply banning other fees.

The rule should also ban late fees or other penalty fees, which typically are not considered finance charges and thus are not encompassed within the APR cap. As Lois Kitsch pointed out in her comments, the ban on rollovers will send some loans into delinquency. Longer terms and installment payments will help avoid delinquencies, but some may be unavoidable. Borrowers should not be sent deeper into a debt trap by allowing late fees to pile on. Credit unions should also not profit from a consumer's delinquency by being able to charge a late fee.

Credit unions, like banks, have used penalty fees as a way of generating income, not just affecting consumer behavior. Overdraft fees, credit card over-limit fees, and late fees all are a source of profits. The rules should avoid any incentive to structure loans in ways that lead to income from penalty fees.

Payday lenders are typically prohibited from charging late fees, and credit union that offer small loans at the higher rate permitted under the proposed rule should be too. A rate of 28% is already very high. Interest will continue to accrue as long as the loan is unpaid. But late fees can add disproportionately to the cost of the loan and undermine the 28% rate cap. They should be prohibited.

C. Loans Made at the Higher Rates Must Carry A 90-Day Term Or At Least One Month Per $100, And Should Require Multiple, Amortizing Payments.

The proposed rule permits loans as short as 30 days and permits single, balloon-payment loans. Even with a low rate and few or no fees, the struggling consumers who need small loans are unlikely to be able to repay the loans without falling behind the next pay cycle. The Board is right to be "concerned that requiring a member to pay back the entire amount or a substantial portion of an STS [short-term, small amount] loan in one payment may not be feasible for some borrowers and may exacerbate a borrower's weak financial situation" and "may cause additional financial problems for borrowers or lead them to return to payday lenders."[12] The same concerns also dictate a minimum term longer than 30 days.

[12] 75 Fed. Reg. 24500 (May 5, 2010).

Many of the credit unions that currently offer STS loans structure them as 30-day single repayment loans.[13] This structure is problematic even at the existing 18% rate. To qualify for a higher interest rate, loans should be required to carry a term of 90 days, or at least one month per $100 borrowed for loans under $300, and to require multiple, fully amortizing payments at least once a month.

Though the proposed rule technically bans rollovers, the 30-day, lump sum loans permitted by the proposed rule are likely to lead to rollovers in practice. The proposed rule states that an FCU "must not roll-over any STS loan,"[14] but the rule does not explain what that means. As many states have found, rollover bans are very difficult to enforce. A ban on rollovers does not stop a borrower from repaying a loan and then taking out a new one a day or a week later, when the paycheck runs out – or even the same day.

When borrowers do not have sufficient time to repay their loans in multiple manageable payments, they often become locked in a debt cycle, compelled to engage in repeat borrowing – such as rolling over loans by paying only the finance charge or taking out back-to-back loans – to meet their repayment obligations. The phenomenon of repeat borrowing is well documented with respect to traditional payday loans and was noted by NCUA in this notice of proposed rulemaking.[15] Payday borrowers take out an average of 8 to 9 loans annually.[16] A study by the Center for Responsible Lending found that 76% of payday loans are churned loans – ones that are made not because of a new need for credit, but because the borrower needs a new loan to pay off a previous unaffordable payday loan.[17]

Even at rates far below payday rates, and even with a slightly longer term, rollovers are likely to be a problem. The rollover problem is caused as much by the short term and single payment of payday loans as by the high rate. If a borrower takes out a $300 payday loan at $15 per $100, the payment is $345 in 14 days. If a single-payment loan instead has interest of 28% and the $20 fee permitted by the proposed rule, the payment is $327. The difference is not big enough to make the loan more affordable in the short term. The bulk of the immediate problem comes from repaying the principal, not the finance charge.

Although 30 days is longer than a typical payday loan, it is still not long enough to ensure that borrowers are able to dig themselves out of whatever financial holes caused them to borrow in the first place. For low- and moderate-income payday borrowers, a

---

[13] *See* NCLC, *Stopping the Payday Loan Trap,* Appendix A-3 at 37-43.
[14] 75 Fed. Reg. 24501 (May 5, 2010).
[15] 75 Fed. Reg. 24497 (May 5, 2010).
[16] This data is discussed in further detail in Uriah King and Leslie Parrish, *Springing the Debt Trap*, Center for Responsible Lending (Dec. 13, 2007), available at http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap-exec-summary.pdf.
[17] Uriah King & Leslie Parrish, Center for Responsible Lending, *Phantom Demand: Short-Term Due Date Generates Need for Repeat Payday Loans, Accounting for 76% of Total Volume* (July 2009) "Phantom Demand"), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-date-generates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html.

small loan of $350 to $400, the size of a typical payday loan, takes a huge bite out of the borrower's monthly income. A payment of $175 to $200 plus finance charges for two consecutive pay periods is not much easier. For the larger $1,000 loans permitted under the proposed rule, it is hard to imagine many borrowers who could afford to repay the loan in 30 days.

Borrowers with the cash flow to come up with the extra cash in just one month most likely have other, more affordable options, such as emergency savings, credit cards or overdraft lines of credit at their banks. Payday borrowers, by contrast, typically live paycheck to paycheck with little or nothing left over. Various studies have found that 40 to 60% of consumers take out payday loans to cover routine expenses like utility bills, rent or groceries, or nonessential items.[18] The chances that borrowers with this type of cash-flow problem can repay those loans in 30 days without causing an even larger shortfall the next pay period, leading to repeat borrowing, are remote. The situation is little different if the loan is occasioned by an unexpected need that the borrower cannot address with the current paycheck.

A single payment structure, regardless of the term of the loan, also contributes to a debt cycle. Balloon payments are one of the hallmarks of predatory lending.[19] They trap the borrower into a debt spiral and force repeat loans. The loan continues until eventually, out of desperation, the borrower finds some way of coming up with that balloon payment – often friends, family, skipping more important expenses, or bankruptcy (options that were likely available before the borrower took out the loan and incurred months worth of fees).

Whether the loan is 30 or even 90 days, a single payment structure[20] requires the borrower to resist the everyday demands on the paycheck and to set money aside for the balloon payment when it comes. In effect, the borrower has to make installment payments to his or her savings. Payday borrowers who are living paycheck to paycheck are likely to have extreme difficulty doing so. If the borrower has not saved, then at the

---

[18] Federal Deposit Insurance Corp., *National Survey of Unbanked and Underbanked Households* at 42 (Dec. 2009) (38% of underbanked households that used some form of alternative financial service credit product did so to pay for basic living expenses, 6.2 did for special gifts or luxuries, 15.4% to make up for lost income, 7.4% for house repairs or to buy an appliance, 4.5% for car repairs, 2.3% for medical expenses, 1.6% for school or childcare expenses, and 24.9% for other reasons); California Budget Project, *Payday Loans: Taking the Pay Out of Payday* at 25 (Sept. 2008) (reporting on study by Calif. Dep't of Corp.), *available at* http://www.cbp.org/pdfs/2008/080926_paydaychartbook.pdf (50% to pay bills; 22.3%, to buy groceries and other necessities; 10.3% for an emergency; 1.8% to repair a vehicle); Texas Appleseed, *Short-Term Cash, Long-Term Debt: A Survey of Payday Borrowers* at 9 (Apr. 2009) (over half cited the need to pay routine utility bills, to buy groceries, gas or to pay rent; 38% had an emergency); Michael S. Barr, *Payments, Credit and Savings Among Low- and Moderate-Income Households: Evidence from the Detroit Area Survey*, Federal Reserve Bank of Philadelphia (May 22, 2007) (60% used payday loans to pay for everyday expenses; 11% paid credit card or bank debt).

[19] *See, e.g.*, Office of the Comptroller of the Currency, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, OCC Advisory Letter AL 2003-2 at 2 (Feb. 21, 2003).

[20] Some lenders permit the borrower to repay in installments or in a single payment. That is little different than a single payment loan. A payday borrower who is given the choice of making a payment today or waiting will likely wait. And a borrower presumably can always offer an early partial payment even on a single payment loan.

end of the day the impact of making the lump sum payment from a single paycheck is the same whether the term is 14 days or 90.

The short term and single payment structure permitted by the proposed rule is especially problematic in light of the permission for a $20 application fee for each new loan. The fees are less likely to multiply if the term of the loan is longer and it is repaid in installments that do not drive the borrower into repeat lending.

The most effective way to truly ban rollovers is to require the loan to be stretched out over sufficient time and with small enough payments that it can be made within the borrower's budget. Time to chip away at the debt in reasonable bites is essential. The payments are more affordable because they need not cover the entire loan amount. Each payment must cover part of the principal, not just accrued fees and interest, so that with each payment the borrower is making steady progress. With no sudden balloon payments at the end, the final payment does not send the borrower back into the cycle of borrowing again.

The recommended term of at least 90 days or one month for every $100 borrowed is consistent with the FDIC's Small Dollar Loan Guidelines. The FDIC explained: "We encourage institutions to utilize a reasonable time frame for the repayment of closed-end credit, e.g., at least 90 days. This should enable borrowers to repay the debt without incurring the cost of multiple renewals."[21]

More than theory justifies these recommendations. A 90-day amortizing installment loan requires payments that are very comparable to the payments that payday borrowers are able to come up with today. A $300, 90-day loan at 28% with a $20 application fee would require payments every 14 days of about $51. That is very close to the $45 due for a payday loan at $15 per $100 (and less than the $60 due to payday lenders who charge $20 per $100). Payday borrowers make those payments all the time – but do so without making any progress on the principal.

Consequently, requiring a longer term and multiple installment payments will result in loans that have payments that payday borrowers can actually meet, while paying off their loans in a reasonable period of time and not falling behind the next pay cycle. NCUA should amend proposed § 701.21(c)(7)(iii)(2) to provide that STS loans made by credit unions must have a minimum term of 90 days or one month per $100 borrowed for loans under $300 and must require multiple, fully amortizing installment payments that are due at least monthly.

D. Qualifying Loans Should Not Mandate Electronic Repayment or Otherwise Require the Electronic Equivalent of Check Holding.

Check holding is a well known feature of traditional payday loans that increases their danger. Consumers who take out traditional payday loans at a storefront lender

---

[21] FDIC, Affordable Small Dollar Loan Guidelines at n.6 *available at* http://www.fdic.gov/news/news/press/2007/pr07052a.html.

must write a check, which is either post-dated or held for deposit for two weeks, for the amount of the loan plus the finance fee. But consumers who do not have $300 today are unlikely to have $345 in two weeks, and the threat to deposit the check either induces consumers into rolling over the loan or causes an overdraft. Both internet and storefront payday lenders also accomplish check holding through the electronic equivalent of taking authorization for an electronic debit or authorization to create a remotely created check, with the same results.

Electronic check holding is not unique to payday lenders or high cost loans. As NCLC's report *Stopping the Payday Loan Trap* found, many credit unions that offer small loans at prices well below payday lenders require automatic electronic repayment or otherwise secure the loans by electronic access to the consumer's bank account.[22] This form of security is very dangerous, even in the hands of an otherwise responsible lender. As detailed in greater length in the NCLC report, the consumer loses control over the account; the loan payment comes before food; protections for exempt funds like Social Security and Unemployment Insurance or a core amount of wages are evaded; and this form of asset-based security leads lenders to ignore underwriting to ensure the loan is actually affordable to the consumer.[23]

NCUA should require all credit unions to abide by the both the letter and spirit of the Electronic Funds Transfer Act, which prohibits conditioning credit on electronic repayment.[24] NCUA should especially prohibit lenders who make higher-rate small loans under the proposed rule from requiring electronic repayment or electronic security tied to the consumer's assets.

As NCUA noted in the proposed rules, the proposed 28% rate, which is 1000 basis points above the established interest rate ceiling, "is sufficient for FCUs to offer STS loans with a reasonable return *considering that they are unsecured* …."[25] A loan that is conditioned on electronic payment or is otherwise secured by electronic access to the consumer's bank account, however, is not unsecured. Higher rates are unjustified for secured loans.

A ban on security tied to the account could include an exemption for loans that include a savings component that is frozen and serves as security until the loan is repaid. That form of security does not endanger and is not secured by the consumer's wages or other assets that the consumer had before the loan was made.

E. Credit Unions Should Be Permitted to Require Direct Deposit (Without Mandatory Electronic Repayment) But Not Payroll Deduction.

[22] *See Stopping the Payday Loan Trap* at 24, Appendix A-2, 35-36.
[23] *See Stopping the Payday Loan Trap* at 15-17.
[24] 15 U.S.C. §§ 1693-1693r.
[25] 75 Fed. Reg. at 24498 (May 5, 2010) (emphasis added).

The Board asks for comment on whether credit unions should be permitted to require borrowers to participate in direct deposit or a payroll deduction program as a condition of an extension of credit under the rule.

We believe that it is acceptable to require direct deposit of the consumer's income as a condition of credit as long as automatic repayment is not required (discussed above). Direct deposit is a useful way of verifying income and ability to pay and requires the borrower to have an ongoing relationship with the credit union that bolsters sound underwriting. Requiring direct deposit also limits the number of institutions from which the borrower can seek multiple loans, as banks and credit unions that offer small loans often require direct deposit. If the consumer's income is directly deposited into a credit union account – and payments to payday lenders or others are coming from that account – the credit union also has the ability to see which consumer might not benefit from another loan and instead be better off with credit counseling.

On the other hand, payroll deduction should not be required as a condition of credit, for the same reasons as outlined above for mandatory electronic repayment. Payroll deduction is every bit as risky as – and from the consumer's perspective is identical to – mandatory electronic repayment which the EFTA bans as a condition of credit. Payroll deduction gives the lender guaranteed security that is not justified on a higher rate loan, undermines the need to truly evaluate ability to pay, puts the loan payment ahead of food if the loan proves unaffordable, and undermines legal protections for the basic amount of wages needed for necessities.

This is not to say that there is not a place for employer-based lending programs. Many employers are willing to pay salary in advance, without any finance charge. Employers who have relationships with credit unions could also promote loan programs that are only available to their employees without mandating payroll deduction.

F. The Higher Rate 28% Rate, And Even A 36% One, Should Be Permitted With Conditions.

We do not object to a 28% interest rate ceiling for small, short-term loans, *provided* that they meet the additional requirements discussed above:

- No more than one $20 fee for six months and no other fees, including late fees.
- A term of at least 90 days, or one month per $100 for loans under $300.
- Multiple, amortizing payments; no balloon payments.
- No mandated electronic repayment and no other electronic security.

A number of loans that meet these criteria are discussed in *Stopping the Payday Loan Trap.*[26] These conditions are essential because the 28% is a high rate, well above the current legal usury rate. A credit card rate of 28% is considered a penalty rate. Many credit unions have been able to make small loans at current 18% levels. It is therefore

[26] *See Stopping the Payday Loan Trap* at Appendix A-1, 30-34.

essential that any permission to charge a higher rate also come with the responsibility to follow the requirements set forth above.

NCUA also asked for comment on the possibility of using a 36% APR, inclusive of all fees, either as an alternative to or in lieu of the structure in the proposed rule. We support an alternative permitting periodic interest up to 36% *with no fees of any kind*, including late or other penalty fees. That is, the finance charge would be borne solely by the periodic interest rate.

We do not support a "fee-inclusive" 36% rate cap. Current TILA regulations do not require creditors to calculate or disclose a fully fee-inclusive APR. Instead, loopholes allow them to exclude certain fees from their calculations. The "APR with fees" that NCLC recently calculated in its report *Stopping the Payday Loan Trap* ignored several of these loopholes in TILA regulations in order to calculate a fully-fee inclusive APR that reflected the true cost of credit.[27] These fee-inclusive APRs were also exceedingly difficult to calculate and included numerous nuances depending on the wide variety of ways in which loans and repayments were structured. It will sow far too much confusion to permit credit unions to adopt combinations of fees and interest charges that are purportedly under 36%. Until and unless the TILA regulations are revised to require a uniform and air-tight fee-inclusive APR, it is too difficult to explain or police a fully fee-inclusive rate cap.

Without any fees, however, a rate of 36% may even be preferable for borrowers than 28% with a $20 fee. For the small, short-term loans contemplated by this rule, the cost will likely be lower. A rate with no fees also avoids the pitfalls of multiple application fees for new loans. Thus, we support giving credit unions the option of a 36% rate with no fees for loans that meet the other terms discussed above.

G. Responsible Open-End Lines of Credit Should Be Permitted Under The proposed rules.

Responsible open-end lines of credit should also be permitted to take advantage of the higher rate permitted under the proposed rule, which currently is available only for closed-end loans. Open-end lines of credit are cheaper for a credit union to administer than repeat loans and can serve multiple consumer needs. Therefore, NCUA may have greater success in persuading credit unions to use the new rules to offer affordable alternatives to payday lending if open-end lines of credit are an option. Several of the affordable small loans discussed in NCLC's *Stopping the Payday Loan Trap* are open-end products.[28]

Open-end products are not problematic as long as they meet the same criteria recommended for closed-end loans. At the 28% rate, there should be no more than a single annual fee of approximately $20 and all other fees, including late fees, should be prohibited.

[27] *See Stopping the Payday Loan Trap* at Appendix B, 44.
[28] *See Stopping the Payday Loan Trap* at Appendix A-1, 30-34.

It is especially important to include an explicit ban on fees with an open-end product, as there are more loopholes in the TILA rules regarding the finance charge for open-end credit, and calculation of the APR is more difficult, especially before the loan is made. If the Board authorizes a 36% rate, there should be no fees of any kind.

As with closed-end loans, repayment should be in multiple, fully amortizing payments, not in single balloon payments, over at least 90 days or one month per $100 for extensions of credit over $300. It would be appropriate to cap the amortization period at six months in order to be consistent with the goal of quick repayment and not long term debt.

H. NCUA Should Require Data Reporting For Those Who Offer Loans Under The New Rules And Publicize The Results.

Credit unions that currently offer small loans use different combinations of rates, fees, repayment periods, single and multiple payments. NCUA's proposal also permits credit unions some flexibility in designing small loans under the proposed rate structure. As discussed above, in some respects we believe that that flexibility should be constrained to ensure that the loans will be safe and affordable. Even within our recommendations, however, not all loans would be the same.

NCUA should take this opportunity to learn which loan structures and other features work for both consumers and credit unions. If certain types of loans prove to have high default rates, lead to repeat lending, or trigger overdraft fees, bank account closures or other side effects, NCUA should consider amending the rule to restrict those products. Conversely, NCUA should promote the products that prove sustainable for both credit unions and consumers.

NCUA should require that any credit union that makes loans using the higher rates proposed under this rulemaking submit data to NCUA including:

- The terms of the loans;
- The number of loans made;
- The median and range of the amount borrowed;
- The timing and frequency of subsequent loans to the same borrower;
- Underwriting criteria, including typical credit score and other requirements;
- Default rates;
- Incidence of overdraft fees and account closures among borrowers and how that incidence compares to the rate for similar members who do not take out small loans.

NCUA should then aggregate this data and publish a report summarizing it.

NCUA should also seek similar information regarding payday loan alternatives made to credit union members under current regulations. NCUA has already identified the credit unions that make small loans, but it does not have or has not publicized data on the terms, volume or other characteristics of those loans.

NCUA should launch a project similar to FDIC's now concluded Small Loan Pilot Project.[29] Though in the end only 28 banks participated in the FDIC program, we believe that small loans are much more routinely offered by credit unions, through both specialized loan products and standard signature loans. The results of such a project could be to publicize the successful programs already in existence, under current rules, that offer responsible small dollar loans to this population.

IV. CONCLUSION

We encourage NCUA to ensure that affordable small, short-term loans are available to consumers by taking appropriate investigatory and enforcement measures against credit unions, federal and state, currently making or facilitating triple-digit loans above their usury rates. NCUA could also do more to help struggling consumers by addressing pernicious fee-based overdraft programs, which are widespread among credit unions. Both of those steps are more important than encouraging more small, short-term loans.

That said, we support the proposal to permit a higher interest rate for certain small, short-term loans, but if and only if it is modified to ensure that the loans will be truly safe and affordable. Those modifications include requiring a longer term, requiring multiple, amortizing payments, prohibiting more than one $20 fee every 6 months or every year, and no other fees, and prohibiting a requirement for electronic security. Thank you for the opportunity to submit these comments.

[29] Information about the Pilot, including a final report, is available at http://www.fdic.gov/smalldollarloans/.