Sample Comments to the National Credit Union Administration on Short-Term, Small Amount Loan Proposal, 75 Fed. Reg. 24497 (May 5, 2010) (due July 6, 2010)

[Note: NCUA has proposed to raise the usury cap on certain short-term, small amount loans in order to encourage more credit unions to offer affordable alternatives to payday loans. NCUA proposes to permit rates up to 28% with a single $20 application fee for closed-end loans of 30-days to 6-months of $200 to $1,000. No rollovers would be permitted, and no more than three loans could be made in any 6-month period. NCUA has also asked for comment on whether to permit a 36% rate inclusive of fees.]

1. NCUA's first task must be to tighten enforcement of existing usury caps to prevent evasions. As detailed in the National Consumer Law Center's recent report, *Stopping the Payday Loan Trap: Alternative that Work, Ones Those that Don't*,[1] some federal and state credit union are offering triple-digit payday loans in violation of their usury caps. They do so by both manipulating the fees excluded from the APR under Truth in Lending Act regulations, and by not making the loans directly but instead taking a finder's or broker's fee for a loan that would be illegal for them to make directly. Before the NCUA raises interest rates for small loans, it must tighten up its rules to prevent evasion of the existing usury protections.[2] Credit unions that are looking for more income for their small loans will have no reason to follow new rules if they can more easily exploit loopholes in the existing regulations.

2. NCUA must ensure that the structure, and not just the rate, of the loans results in a safe and affordable product. Many of the credit unions that currently offer low cost small loans structure them as 30-day single payment loans. Even with a low rate and few or no fees, the struggling consumers who need short term loans are unlikely to be able to repay a loan that has such a short repayment period and has a balloon-payment structure that requires the consumer to come up with the entire amount plus the finance charge in a single payment. As detailed in *Stopping the Payday Loan Trap*, a truly affordable small loan should have a repayment period of 90 days or more, or at least one month per $100. In addition, the loan should require multiple, amortizing payments at least once a month. Without these protections, consumers are likely to fall behind the next pay cycle and to get trapped in a cycle of borrowing, even if the loan rates are low.

3. NCUA should prohibit no more than one, or at most two, application fees per year and no late fees. 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 (or 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 few days later. A 30-day, $300 loan at 28% with a $20 application fee taken off the top yields **a**

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

[2] A detailed explanation of the various legal tools that NCUA has to crack down on these evasions can be found in the National Consumer Law Center's January 27, 2009 letter to NCUA, available at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/letter-ncua-payday-0109.pdf.

true APR with fees of 116%. Instead, only one application fee should be permitted each year. Or, because $20 is on the low side, no more than two (one every six months). Late fees should also be prohibited, because otherwise those fees, especially if imposed on short, single-payment loans, could be used to pad the rate.

4. Qualifying loans should not require the electronic equivalent of check holding. Many credit unions require electronic payment as a condition of their loans, or otherwise secure them by electronic access to the consumer's bank account. As detailed in *Stopping the Payday Loan Trap*, this form of security is very dangerous, as the consumer loses control over the account and the loan comes before food; protections for exempt funds like Social Security and Unemployment Insurance are evaded; and this form of security leads lenders to ignore underwriting to ensure the loan is actually affordable. NCUA should require credit unions to abide by the both the letter and spirit of the Electronic Funds Transfer Act, which prohibits conditioning credit on electronic repayment.

5. NCUA should encourage credit unions to offer responsible open-end products instead of fee-based overdraft programs. Whether through the new rules or under existing regulations, more credit unions need to develop low cost, small lines of credit that are available for overdraft protection and small, short term credit needs. The proposed rule permits the higher interest rates only for closed-end loans. But open-end lines of credit are cheaper for a credit union to administer than repeat loans and can serve multiple consumer needs. As with closed-end loans, however, fees and repayment schedules must be affordable. At the 28% rate, there should be no more than a single annual fee, and repayment should be in multiple, fully amortized payments over at least 90 days or one month per $100. NCUA could cap the amortization period at six months in order to be consistent with the goal of quick repayment and not long term debt.

6. NCUA should require reporting for those who offer loans under the new rules, including data on repeat lending, default, overdraft fees, and other data in order to evaluate which types of loans are most helpful to consumers. Credit unions are experimenting with different combinations of rates, fees, repayment periods and other structural terms, and NCUA should take this opportunity to learn which of these structures works for both consumers and credit unions. If certain types of loans prove to have high default rates, lead to repeat lending, trigger overdraft fees, bank account closures or other side effects, NCUA should consider amending the rule. Conversely, NCUA should promote the products that prove sustainable and encourage wide adoption by credit unions.