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October 7, 2016

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1275 First Street, NE
Washington, DC 20002

Re: CFPB Proposed Rule Payday, Vehicle Title, and other Covered Loans; Docket No. CFPB-2016-0025

Dear Ms. Jackson:

On behalf of credit unions across Kansas and Missouri, and the more than 2.3 million credit union members in these two states, the Heartland Credit Union Association (HCUA) is providing comment on the proposed rule by the Consumer Financial Protection Bureau (CFPB) concerning payday, vehicle title, and other small-dollar loans. HCUA appreciates the opportunity to share our concerns and feedback on the potential impact of this proposal.

Kansas and Missouri's credit unions offer safe and affordable access to small-dollar loans for credit union members who may otherwise have no access to credit. This is a very important issue for our credit unions, as it affects many consumers in our area. Leaders from credit unions across Missouri and Kansas attended the field hearing on this issue in Kansas City in June, in anticipation of what would be discussed. However, we were significantly concerned with the CFPB Small Dollar Loan Proposal that was revealed, as it threatens our member credit unions' ability to provide this essential service to their members. The proposal increases regulatory burden on credit unions, despite the support of CFPB Director Richard Cordray, who highlighted credit unions as examples of success in providing payday lending alternatives.

It is important that credit unions remain able to provide small dollar loans to members who need them, and that ability is significantly challenged in the current proposal. As such, HCUA suggests that the CFPB withdraw the rule, as written, in its entirety. In the absence of a retraction, HCUA urges the CFPB to utilize its authority to exempt credit unions from this proposal. Recognizing that the CFPB may not use either of these options and retain credit unions as covered entities, HCUA offers suggestions and concerns that must be addressed for consumers to have continued access.

Background

Credit unions are the original consumer protectors in the financial services industry. Owned by their members and operated as cooperatives, credit unions' core mission is to promote thrift and provide access to credit for provident purposes. Kansas and Missouri credit unions began on the verge of the Great Depression, when traditional financial institutions were unable or unwilling to provide financial services. Our earliest members worked together and pooled their financial resources to create safe opportunities for saving and lending – for themselves and for their communities. Making small loans is at the core of that history, and continues today in our member credit unions across both states. HCUA is quite concerned that CFPB's proposal sweeps in and threatens the stability of these consumer-friendly products offered by our member credit unions. The overly burdensome proposed rule misses the mark of enhancing consumer protections. It fails to consider consumers' needs, particularly those of modest means with financial challenges, and does not provide a clear and concise path to allow credit unions to meet these needs.

The demand for small dollar, short-term credit is very high. Too often, borrowers pay an extraordinary price for the speed, convenience and anonymity provided by storefront and online payday lenders, title lenders, pawnbrokers, and check cashers instead of turning to highly regulated depository institutions. However, low-cost, streamlined underwriting is required to offer these products on a long term basis.

"All-In" APR Approach
HCUA strongly recommends that the CFPB abandon its "All-In" APR approach. Rather than the definition of APR under the Truth-in-Lending Act (TILA), Regulation Z, the CFPB has proposed a new definition to determine the all-in measure of the cost of credit. Under the proposed definition, "all-in" would include the total amount of charges imposed in connection with the loan, including charges for credit insurance, ancillary products, finance charges as set forth in regulation, application fees, and fees for participation in any plan or arrangement for a covered loan. TILA does not require the inclusion of these products in the cost of finance.

Considering the obstacles the credit unions have encountered when implementing the new Military Lending Act APR (MAPR), the CFPB should consider the feasibility of a credit union offering a product that would require a third calculation. Historically, credit unions have shown an ability to offer consumer-friendly, low-cost, short-term loans to their members. However, the proposed rule may negate any incentive for a credit union to continue to offer such products. The CFPB should exempt credit unions from the rule altogether.

Membership Fees
As proposed, membership fees are included in the total cost of credit because it may be interpreted to be a fee in connection with a covered loan. We urge the CFPB explicitly and clearly exclude membership fees from the cost of credit.

Ability-to-Repay
The proposed rule states that because lenders could be conditionally exempt from complying with Ability to Repay (ATR) requirements, this would reduce the compliance costs for lenders that make covered short-term loans relative to the costs of complying with the ATR requirements under this proposal. We would caution the CFPB to further analyze this assumption for several reasons:

- Not all loans will fall into one of the exemption categories.
- Even for those that do fall in one of the exemption categories, there are compliance burdens associated with all covered loans that are subject to payment transfer, notice requirements, compliance programs, and record retention rules.

Beyond the extreme burden of engaging in ATR, there is also a lack of clarity on a number of the factors in the ATR analysis. For example, what does the CFPB mean by "basic living expense?" Credit union underwriters may run into obstacles when attempting to project exact living expenses, net income, and debt obligations. Housing costs could be potentially impossible in some circumstances, particularly for subprime borrowers who are underemployed, living in rental properties, and facing any number of financial challenges. Many consumers are not necessarily paid biweekly or monthly, and this proposal does not account for that. Additionally, making such precise projections, some of which could be based on assumptions, could subject the credit union to liability.

Conversely, the specificity outlined in other parts of the proposal would create a liability or potential for violation of the rules if credit unions do not conform to the extremely prescriptive requirements.

Another concern regarding the ATR requirements is that pulling a member's credit report several times a year for such small loans may have a notable negative affect on the member's credit score. This new underwriting requirement will increase the amount of time a credit union needs to analyze a potential borrower's eligibility. The delayed access to these products directly conflicts with the member's need for an immediate, short-term loan. HCUA fears that these members would be left without access to legitimate consumer-friendly products.

5% Payment-to-Income Ratio
The current proposal does not include the 5% payment-to-income ratio, and HCUA strongly supports leaving it out of the proposal due to the potential chilling effect on current programs. HCUA reached out to Kansas and Missouri credit unions regarding this concept, specifically asking those who currently offer payday lending alternatives how this would impact their current programs. Overwhelmingly, most credit unions currently participating in payday lending alternatives expressed concern with the impact and long-term viability in operating their programs, and the resulting impact on borrowers in access to obtaining small-dollar loans. There is significant concern that a 5% payment-to-income ratio would regulate many payday alternative loan products out of existence, which would be a negative for consumers in need of small dollar loans.

Right of Set-Off
HCUA recommends that the CFPB remove the prohibition to the right of set-off from both exemption sections to which it is proposed. The right to set-off is a viable method for credit unions to recoup funds given a non-payment default. The set-off ability of credit unions provides safe and affordable credit to consumers. We have not seen any research or evidence from the CFPB that credit unions have inappropriately used this right, especially for small loans.

Default Rates
HCUA recommends that the CFPB remove the rigid requirements for monitoring default rates or to exempt credit unions from these requirements. Credit unions presently have existing policies and procedures which reflect their safety and soundness priority. While credit union default rates for small dollar lending may be less than five percent, this would not be the case for all credit union small dollar lending - particularly for these riskier loans. The default calculation differs from that of the credit union model. Credit unions have indicated that if the CFPB calculates "monthly balance outstanding" rather than "original loan amount," it could lead to a significantly higher default rate than five percent.

Less than 46-Day Loans
The proposed requirements for short-term loans of 46 days or less are inappropriate and threaten the decision of credit unions to offer these types of loan products. Under the proposal, lenders would have two options for making short-term loans. The first option would require the lender to conduct an ATR test on the borrower. The second option would not require an ATR assessment, but would require that the loan satisfy certain prescribed terms. While the CFPB appears to have a preference for longer term, small dollar credit, rather than for loans less than 46 days, we urge the CFPB to further consider that some credit union members want and need loans for a shorter period of time. For certain members, the shorter the loan, the easier it may be for them to manage their finances. Accordingly, some credit unions offer loans for a timeframe of less than 46 days.

The Anti-Evasion Provision
Congress gave the CFPB clear supervision authority over the payday lending industry, and the CFPB has the tools to address any problems that may arise. The anti-evasion provision of § 1041.19 is an extraordinarily broad provision that creates confusion and arguably is not within the spirit of the Dodd-Frank Act. The Act did not provide the CFPB with blanket catch-all authority Anti-Evasion clauses, which are normally found in the criminal context, not in a regulatory oversight regulation. It appears that any minute change to a lending program under this standard could be considered "evading." As this rule is put into practice and changes are necessary, HCUA suggests that the CFPB use its ability and powers to amend the rule through the typical rulemaking process.

Kansas and Missouri Credit Union Examples of Payday Lending Alternatives
Both Kansas and Missouri have a significant number of state-chartered credit unions. Due to this, exposure to the National Credit Union Administration's (NCUA) Payday Alternative Loan (PAL) program for federal credit unions is not as widespread in our states as others nationwide. That does not mean that Missouri and Kansas consumers do not have access to payday lending alternatives, however. In August and September of 2016, the Heartland Credit Union Association (HCUA) asked its member credit unions to provide examples of small dollar loan options they provide, and the impact on our credit union members in need of small dollar loans. The following examples reflect payday lending/small dollar loan programs offered by Kansas and Missouri credit unions.

Example 1:
This central Missouri credit union offers a payday loan product with a $500 credit line. To qualify, the member must:

- Be a member for 60 days.
- Be on their job for six months.
- Make at least $1,000 per month.
- Have no negative checking account history in the past 15 days.

The interest rate varies between 26% (member with direct deposit) or 36% (if no direct deposit). Because of the risk associated with higher delinquencies and charge offs, there is a $50 annual fee on the credit line. To help teach responsible borrowing habits, the credit union requires the credit line be paid in full before the member can draw on it again. This program has been successful since the credit union started offering this product in 2007.

Help does not just come in the form of the payday loan alternative product. In one central Missouri branch alone, the credit union closes 3-5 small unsecured loans totaling less than $1,000 each day. There are no origination fees and the interest rates are 7.5% - 21.5%, based on the borrower's credit score. These loans are used for a variety of reasons, ranging from tires for their car, emergency funds for utility bills and groceries, school supplies for children, vehicle repairs, and other emergency reasons.

There would be negative consequences if this credit union's members were unable to access small, low cost loans. Here are a few recent situations where the credit union helped members in financial distress:

- *We had a member who needed a $200 loan just to buy gas for his car to make it to work each day the rest of the pay period. He would have lost his job if he was not able to get to work. He didn't have gas money because of unexpected car repairs that he paid for a week earlier. The interest on $200 loan over four months at 21.50% = $9.98. A payday* *loan would have cost more than he could afford. We helped him so he could keep his job.*

- *Another member came to us because she had unexpected dental work that needed to be done and needed $800. She was in dire pain and could not work or function in most daily situations until she had the dental work done. We gave her the $800 loan at 13.50% interest (rates are based on credit score). The loan had total interest of $50 over a 12-month term. This allowed her to afford the loan payment and still survive on her limited monthly income.*

- *A member recently needed $150 for a delinquent utility bill. Her utilities were on the verge of being shut off due to non-payment. The father of her children stopped paying child support, which caused her to not have money for utilities. We helped her out with a $150 loan at 19.50% interest over four months, with total interest of $4.95. Total payback of $154.95. This allowed her to keep the utilities on for her children.*

Credit union staff also provides essential financial education to various groups within the community. This includes working with a Mid-Missouri non-profit agency focused on eliminating poverty, working with local employers to provide financial workshops to employees, and the local Chamber of Commerce to host seminars during a 'Financial Wellness' day.

Example 2:
This credit union in the Kansas City area has saved members an estimated $2,000,000 since entering the payday lending space in 2002. The payday lending alternative is operated out of the credit union service organization (CUSO), and offers services to members and other credit unions. Discounted rates are offered to members who participate in the credit union's financial education program. Savings are even greater as compared to the typical ONLINE payday lender. However, if the short-term loan rule is finalized as it is written, there is concern that future savings would no longer be available to consumers as credit union leaders say the CUSO would be regulated out of existence.

Example 3:
This Springfield, Missouri area credit union started a fresh start checking account in 2014, geared towards consumers who are unable to open a regular checking account anywhere else due to past issues with previous checking accounts at other financial institutions. There is a $7.50 fee per month due to the level of monitoring required. After 12 months without issues, the consumer is moved to a regular, free checking account program.

The credit union recently began to offer a fresh start payday loan alternative, with 30 accounts opened so far. The fresh start payday loan alternative is an open-ended $500 line of credit with a term of either 90 or 180 days. Members must have used a credit union account with no charge-offs for at least 90 days. There are no cards associated with the loan. Eligibility for the program is determined by an automated system and an explanation is provided immediately if the member is denied or deemed ineligible. The explanation also includes information on what the member needs to do to obtain the loan in the future.

The program includes a reduced fee and reduced interest rate for members who utilize direct deposit. For a $500 loan paid off in 90 days, the total cost is $22. For a $500 loan paid off in 180 days, the total cost is $38. There is a savings element to the program, as 10% of the loan is placed into a savings account. For a $500 loan, there is $50 in a savings account. Once the loan is paid off, consumers have access to the savings. The credit union has already suffered its first loss in this brand new program, when someone opened the loan and declared bankruptcy the next week.

Example 4:
This faith-based, Kansas City area credit union started its payday lending alternative program in 2014. People who are eligible for the program are participants of the Community Services League in Eastern Jackson County. Since its inception, the program has made 65 loans for a total of $251,862. The annual percentage rate charged ranges from 5% to 21%. There is no loan limit, and most loans are in the range of $500 to $3,000. Collateral provided includes Signature, Title and Home Equity Line of Credit. The criteria used to approve the loan include ability to repay the loan and past financial history. The average credit score of borrowers is 553. For most participants, the purpose in obtaining the payday lending alternative loan range from refinancing payday/title loans, purchasing a car, and refinancing high interest car loan, to paying for household expenses, paying back real estate taxes, and as a credit builder.

Example 5:
This St. Louis area credit union is an active participant in the effort to combat payday lending by offering alternative products. The credit union has two products: 1) A "payday alternative" product that is offered at an "all in" rate of approximately 36% APR. It has grown to an aggregate balance of approximately $2 million. The average balance is around $488 with just under 4,100 participants. 2) The credit union also provides a payday loan consolidation product (at the same rate) that has an average balance of just under $800. When one calculates the savings at the all-in rate of 36% versus the average rate in Missouri at 440%, the credit union provides members and the market with an economic impact of more than $8 million per year.

Here are details on the credit union's payday lending alternative programs:

Freedom Payday Loan Alternative
• 25% APR; $25 annual fee; 90-day term
• Max line of credit amount of $500
• Credit union checking account opened and active for 90 days
• Checking account in good standing for 30 days
    -No negatives
    -No returns
    -No delinquencies
• No credit check required
• 10% of loan amount is deposited into a restricted savings account; once loan is paid off, funds are available to borrower

Payday Consolidation Loan
• Max loan amount: $1,000
• Installment loan with a repayment term up to 12 months
• APR 25%
• Application fee $25 (cannot be included in financing)
• Can't be used to pay off Freedom Loans
• Active credit union checking account in good standing for 6 months
• No credit check required

Example 6:

This Kansas credit union offers a payday lending alternative through another credit union. Members apply on a third party website, and the program approves/denies the loan. The objective for the credit union in participating in the payday lending alternative is to assist members in getting out of payday loans and/or provide credit counseling to get members to the point where they obtain regular loans versus payday loans. Many of the participants are repeat users, where the payday loan alternative is used to pay off an immediate need and the loan is then paid off in two weeks (or by the next payday). The cycle continues when they reapply to meet another shortfall. The program is significantly less expensive than the traditional payday loan, but many users refuse to participate in a financial literacy program that would reduce their rate further.

Summary

The Heartland Credit Union Association agrees that consumers should be protected from abuses in the small dollar credit system. Due to the safe and affordable manner credit unions have achieved this goal, we are asking the CFPB that it not disrupt these valuable programs offered to the consumers we serve. Due to concerns with the proposal as written, HCUA strongly suggests that the CFPB withdraw the proposal altogether. If the CFPB chooses not to take this approach, HCUA asks that the CFPB exempt credit unions from the rule. And lastly, if an exemption is not granted, the HCUA has provided a number of concerns and suggestions on how to make the rule less damaging to the current credit union market.

We have heard from the CFPB that it does not want to negatively influence credit union lending. It is our grave concern that – as written - the complexity and length of this rule will provide roadblocks to our member credit unions from offering these much-needed small dollar loans, and hurt consumers in Kansas and Missouri. We urge the CFPB to take a step back and reassess its approach. Thank you for your time and consideration.

Sincerely,

Bradley D. Douglas

Brad Douglas
President/CEO