May 31, 2016

Comptroller Thomas J. Curry
Office of the Comptroller of the Currency
400 7th Street SW, #3e
Washington, DC 20024
Via electronic submission

RE: Comments on Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective

Dear Comptroller Curry,

The Pew Charitable Trust's consumer finance team includes the consumer banking project, which studies the transaction accounts that Americans rely on to manage their finances and develops research-based policy recommendations that promote safe and transparent products, and the small-dollar loans project, which studies the market for payday loans and their alternatives. We have published a series of reports examining several aspects of checking and prepaid accounts, including overdraft service, and have begun research into new mobile banking and payment features and whether they could provide needed services to the unbanked and underbanked. Our work also includes the "Payday Lending in America" series of reports, a unique and in-depth set of research that has revealed new insights about borrowers and their experiences, and provided extensive policy recommendations for serving these borrowers with safer, lower-cost loans. We appreciate the opportunity to comment on the Office of the Comptroller of the Currency's (OCC) efforts to foster and ensure responsible innovation from the institutions it supervises and their partners.

In these comments, Pew will address questions two (2), four (4), seven (7) and nine (9) as set forth by the OCC. Pew's history of data-driven research in consumer finance has provided a strong understanding of political, market, and consumer-focused issues that can arise when discussing and evaluating innovative products designed to make consumers — particularly the underserved — more financially secure.

Question 2: How can the OCC facilitate responsible innovation by institutions of all sizes?

Innovation can enhance competition and provide better products and services in the consumer finance market. But an innovative product does not, by definition, benefit consumers or the marketplace. For small institutions, building new products can be difficult or impossible, which is why many rely on third-party providers. In order to promote better products, the OCC should be equally interested in fostering positive innovation from banks as well as third parties that will partner with banks, particularly with those institutions that generally do not have capabilities to build products on their own. As the OCC works to foster innovation, it should ensure that third parties are always held to the same standards of consumer protection that apply to banks.

Banks can play a vital role in responding to their customers' needs by providing products that are easily understood and designed to foster the progress of consumers in the banking system, beginning with basic tools to save and spend, and eventually including more sophisticated credit products to meet consumers' needs. The marketing of some products, previously considered "innovative" can provide important lessons going forward. For example, at one time, overdraft service was offered infrequently and was truly meant to help consumers. Unfortunately, debit card overdraft innovations have led to expensive fees that add up quickly and too often push consumers, particularly those of low to moderate income, out of the banking system.[1]

The reordering of transactions from high to low by dollar amount could also be called an "innovation," as the financial institutions that use it have claimed that it helps their customers by ensuring that large transactions (like rent) clear before small purchases. However, Pew's research has found that consumers reject this contention and that this practice maximizes bank fees and drives up costs for consumers. Pew's most recent publication highlights the financial risk for those who incur more than $100 in overdraft fees in a year.[2] Most of these "heavy overdrafters" earn less than $50,000 annually and nearly one-quarter pay the equivalent of one or more weeks of wages in overdraft fees. This is the type of new product feature that the OCC, through this effort, should ensure does not come to the marketplace.

Pew is encouraged by the OCC's efforts to ensure that innovation can be furthered inside the structure of the regulated banking industry. Risk management and safe and sound practices are important, as are efforts to reach consumers that have been left out of the banking system. Any support provided by the OCC to entities that seek advice should reinforce the importance of all of these goals.

While banks and third parties should be encouraged to innovate in ways that better serve their customers, as the OCC's whitepaper states, it is also important that all products adhere to consumer protection laws. These laws are a vital baseline of safety, and new products should always at least meet these requirements, if not go beyond them. Products that do not meet the standards of consumer protection laws are unlikely to be useful. The OCC should make clear that meeting the evolving needs of consumers should only be done within the confines of safe products that abide by current consumer protection laws and regulations.

<u>Question 4: How would establishing a centralized office of innovation within the OCC facilitate more open, timely, and ongoing dialogue regarding opportunities for responsible innovation?</u>

Pew supports the efforts of the OCC to foster responsible innovation. As part of this effort the OCC should provide public access to data collected, while safeguarding information it considers proprietary that could provide a competitive disadvantage to companies that seek advice. For example, a document outlining how a new product meets OCC requirements would not be considered proprietary but certainly the underlying code that is the backbone of the product would. This will be beneficial to consumers and the market. Pew, along with many other research institutions, frequently uses publicly available data to study various markets and practices in order to develop and advocate for better policies. A centralized office of innovation should provide open access to data for the public at large, it would be beneficial.

Providing a forum for innovation that is available to any interested party would make communications between the OCC and the entities it regulates more transparent. This could be helpful not only for parties that wish to hear from the OCC in regard to products they are considering bringing to market, but also for researchers who would like to know about what types of innovation are being contemplated, how the product or service is performing, how much it costs, and the impact on customers' abilities to transact, save or get credit, as well as the risks and benefits of new services to customers. In developing any plan to foster innovation, the OCC should consider what benefits could be provided by creating and sharing databases that could be used by the OCC and the public alike.

The OCC should also consider how a transparent office could further innovation that is useful to consumers. Given time, the office could provide examples of soundly structured innovation that could be used by other companies as they also attempt to bring safe, useful products to the marketplace. Further, the office could use its role to mitigate the effects of poorly designed products, by either suggesting alternatives or providing warnings that certain products would not be considered acceptable.

<u>Question 7: What additional guidance could support responsible innovation? How could the OCC revise existing guidance to promote responsible innovation?</u>

Promoting access to safe products and responsible innovation often entails thinking differently about longstanding procedures and practices, and sometimes this means that regulatory innovation is more important than technological innovation. Nowhere is this more evident than in the payday and small-dollar loans market.

Even though every payday loan customer has a checking account—because that and an income stream are required to get a payday loan—12 million of them go outside of their depository institutions each year to use the services of non-bank payday lenders.[3] Yet banks and credit unions enjoy such potent competitive advantages that they could be providing small loans at prices that are at least six times lower than payday loans.[4] If banks were to offer such loans to their checking account customers instead of having those customers use payday lenders, millions of people could save billions of dollars per year.

Though the OCC, FDIC, and many others have long called for innovations that would lead to safer, lower-cost alternatives to payday and other high-cost loans, there has been little headway on this front. Currently, banks generally do not provide small loans to nonprime customers (with the unfortunate multibillion-dollar exception of fee-based overdraft). Similarly, only 1 in 7 federal credit unions offers a loan under the National Credit Union Administration's "Payday Alternative Loan" program, and in 2014, these institutions made only 170,000 such loans.[5] That is merely a drop in the bucket compared to the more than 100 million payday loans that non-bank lenders originate each year.

The reason is simple: For a depository institution to offer a loan of a few hundred dollars profitably, yet at fair prices, it must cost no more than a few dollars to originate the loan. To achieve this, a bank would have to largely automate the process. That, in turn, takes a mixture of technological and regulatory innovations to foster this kind of pro-consumer development.

In this case, the technology is readily available to banks. They already have ample data about these customers (Pew has previously shared with the OCC a set of "on us" data that banks typically have available in their own databases, which could be used as part of an automated underwriting process; this list is provided as an attachment to this letter). Using techniques that they have already developed for overdraft programs, banks could pre-approve customers for more affordable small loans and automate the process of providing them.

Rather than technology, what appears to be holding banks back from serving this market with lower-cost loans is regulatory uncertainty or even resistance. Pew supports efforts to reform regulations covering overdraft practices, and we supported the OCC's rejection of "deposit advance loans," because such loans mimicked the irrationally short repayment terms and large balloon payments of payday loans, which have led to so much consumer harm. Yet in the wake of the deposit advance guidance, there has been left a large void between overdraft programs that charge consumers a fee of approximately $35 every time a transaction takes a checking account balance negative, on the one hand, and 400% APR payday loans provided by non-bank lenders, on the other hand.

The OCC could help banks fill this gap by working with banks to help them automate the origination of affordable small loan alternatives. At least three of the largest banks in the country have reportedly expressed interest in providing such loans, at prices that are far lower than what payday lenders charge.[6] Pew estimates that a bank could profitably offer a $300 installment loan repayable over three months for a fee of just $35—or about what a single overdraft fee costs today. Further, Pew's research shows that 85 percent of adults in this country say that such a loan is fair, compared to only 29 percent that say a typical overdraft fee is fair.[7]

At the end of the day, underwriting is not the challenge that banks must solve in order to provide fairly-priced small-dollar loans. Banks know how to underwrite loans, and when it comes to offering small-dollar payday alternative loans, they already have powerful data on hand that can help them safely and responsibly provide these loans to their existing checking account customers.

Instead, what is needed are clear product safety standards defining affordable payments and reasonable time to repay. Specifically, regulators should limit monthly payments on small-dollar loans to an affordable 5 percent of the borrower's monthly income, and let $500 loans last no longer than about six months.[8] These and similar safeguards (such as prohibiting origination fees on small installment loans) would not only protect consumers but would give banks the clarity and assurance they need to be able to serve their customers quickly and at low cost.

To accomplish this, the OCC should work — individually and with other federal regulators — to set firm yet clear product safety standards for small-dollar loans, and work with regulated banks to help them identify fast, safe, and low-cost ways of automatically originating the loans so that consumers can quickly get access to better, lower-cost credit.[9]

Question 9: What should the OCC consider with respect to innovation?

Pew is concerned that the OCC's white paper lacks details as to how it will judge innovation, both from a practical and a logistical standpoint. For example, the whitepaper does not discuss how the OCC will foster participation in its innovation center by regulated entities. The white paper mentions that both banks and nonbanks do not understand the "rules of the road." Pew's recently commissioned whitepaper confirms that many laws covering mobile payments are unclear.[10] However, we would urge the OCC to ensure that any steps it takes to clear up confusion caused by ambiguous laws and regulations should not be used by financial institutions to avoid scrutiny of unsafe products. It would be helpful to know how the OCC plans to encourage participation in its innovation center, including what incentives, if any, may be afforded regulated entities.

In addition, the values that must be placed on protecting consumers, providing access, and ensuring a fair and competitive marketplace need to be as clear as possible. For example, it would be helpful if the OCC would lay out what it considers to be the most important factors for assessing what consumers' "evolving needs" are.

While innovation in the financial services industry has proceeded in the past several years at what might seem like a much accelerated pace compared to the 20th century, it is clear that frequently these changes have not been helpful to consumers. Millions remain outside the banking system without access to safe, affordable financial services, either partially (underbanked) or completely (unbanked). For example, the percentage of unbanked households in 2013 has remained unchanged since 2009, despite changes in bank products and services.[11] The impact of innovation in overdraft products has been largely negative, resulting in some consumers moving from the tightly regulated banking system in favor of using loosely regulated general purpose reloadable prepaid cards.[12] The OCC should focus its efforts on innovations that not only help people gain access to better products and services, but also promote financial inclusion and help them manage their financial lives.

Pew has started to examine mobile payments, a fast growing area of consumer finance that could be of great benefit to consumers, particularly the underserved. But our research has shown wariness by consumers in regard to the security and privacy of using mobile payments.[13] Seventy percent of survey respondents cited this concern as an obstacle to mobile payments use. In conjunction with Professor Mark Budnitz, Pew has found that consumers' concerns are likely well-founded, since no comprehensive federal or state law protects consumers from security breaches or privacy invasions and existing law offers only limited protections.[14]

Pew's publications on mobile payments document the problems that can arise when laws do not keep up with innovation. These are lessons the OCC should consider on a proactive basis as both banks and nonbanks participate in its program to foster newer, better financial products. Pew found that at least fifteen federal laws cover some part of the mobile payments marketplace.[15] In addition, these laws are interpreted and enforced by a myriad of government agencies.[16] Further, state laws that fill in the gaps of federal law often vary widely across the country, creating a patchwork of protections for consumers and uncertainty for providers.[17]

Pew's research has shown that opportunities for innovation exist that could offer products to the underserved, but barriers can make this difficult.[18] There is a knowledge gap concerning various aspects of mobile payments technology as it compares to other types of payments. Consumers often do not know how safe, useful, or private different forms of payments are. Consumers will be more receptive to innovative products if they have a better understanding of the protections provided. However, the laws that protect consumers are often confusing for anyone to understand, which makes consumers' concerns about new technology understandable and rational. The OCC could help to both ensure that there is a floor of safety and security for all products in the market and educate consumers about potential benefits of this innovation.

Some new products being developed do not comport with how many consumers, especially underserved consumers, transact today. The number of consumers who mostly deal in cash is significant, and any new products that do not facilitate transfers from physical cash to digital currency will not help these consumers. For innovation to reach the underserved, it will be important to focus efforts on products and services that overcome this barrier.

Overall, Pew's work has shown that responsible innovation can foster greater inclusion in mainstream consumer finance and should be encouraged. But these new products and services can also unleash problems that the OCC can and should address early on so that consumers are protected.

We thank the OCC for this opportunity to comment on this effort to support responsible innovation in the federal banking system. We look forward to the next steps in this process and continuing to share our work with the OCC. As always, we are available to discuss these comments or any other aspect of our work at any time.

Sincerely,

Thaddeus King Officer Consumer Banking Project	Susan Weinstock Director Consumer Banking Project	Nick Bourke Director Small-Dollar Loans Project

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[1] The Pew Charitable Trusts, "Overdrawn: Consumer Experience with Overdraft," (June 2014), 14, http://www.pewtrusts.org/~/media/assets/2014/06/26/safe_checking_overdraft_survey_report.pdf.

[2] The Pew Charitable Trusts, "Heavy Overdrafters: A Financial Profile," (April 2014), http://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/04/heavy-overdrafters.

[3] For further discussion and links, see Bourke, Nick, "How CFPB Rules Can Encourage Banks and Credit Unions to Offer Lower-Cost Small Loans," (The Pew Charitable Trusts, April 5, 2016), http://www.pewtrusts.org/en/research-and-analysis/analysis/2016/04/05/how-cfpb-rules-can-encourage-banks-and-credit-unions-to-offer-lower-cost-small-loans.

[4] McKendry, Ian, "Banks' Secret Plan to Disrupt the Payday Loan Industry," (American Banker, May 6, 2016), http://consumerbankers.com/cba-media-center/cba-news/banks-secret-plan-disrupt-payday-loan-industry.

[5] National Credit Union Administration, Trends and Estimates of Consumer Savings from Payday Alternative Loan Programs, April 29, 2015 (included as attachment to this letter).

[6] McKendry, Ian, "Banks' Secret Plan to Disrupt the Payday Loan Industry," (American Banker, May 6, 2016), http://consumerbankers.com/cba-media-center/cba-news/banks-secret-plan-disrupt-payday-loan-industry.

[7] The Pew Charitable Trusts, "CFPB Proposal for Payday and Other Small Loans: A survey of Americans," (July 2015), http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf.

[8] In a preliminary framework for regulating this market, the Consumer Financial Protection Bureau suggested exactly such a guideline. See: The Pew Charitable Trusts, "Understanding the CFPB Proposal for Payday and Other Small Loans," (July 2015), 11-12, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb-primer_artfinal.pdf

[9] Pew has written extensively about this issue. For more about our core small-dollar loans policy recommendations, see The Pew Charitable Trusts, "Payday Lending in America: Policy Solutions" (Oct. 2013), 44-47, http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs_assets/2013/pewpaydaypolicysolutionsoct2013pdf.pdf. See also: Bourke, Nick, "Regulators Should Let Banks Get Back to Small-Dollar Loans," (American Banker, September 16, 2015).

[10] Budnitz, Mark, "The Legal Framework of Mobile Payments," (Feb. 2016), http://www.pewtrusts.org/~/media/assets/2016/02/legal_framework_of_mobile_payments_white_paper.pdf.

[11] Federal Deposit Insurance Corp., "National Survey of Unbanked and Underbanked Households," 16 (2013), https://www.fdic.gov/householdsurvey/2013report.pdf.

[12] The Pew Charitable Trusts, "Banking on Prepaid," (June 2015), http://www.pewtrusts.org/~/media/assets/2015/06/bankingonprepaidreport.pdf.
[13] The Pew Charitable Trusts, "Is This the Future of Banking?" (Jan. 2016), http://www.pewtrusts.org/~/media/assets/2016/01/cb_futurebankingissuebrief.pdf.
[14] Budnitz, Mark, "The Legal Framework of Mobile Payments," (Feb. 2016), http://www.pewtrusts.org/~/media/assets/2016/02/legal_framework_of_mobile_payments_white_paper.pdf.
[15] The Pew Charitable Trusts, "Mobile Payments: Regulatory Gaps, Ambiguities, and Overlap," Data Visualization (Feb. 2016), http://www.pewtrusts.org/~/media/assets/2016/02/mobile-payments-infographic_artfinal.pdf?la=en
[16] Ibid.
[17] The Pew Charitable Trusts, "Mobile Payments: Regulatory Gaps, Ambiguities, and Overlap," (Feb. 2016), http://www.pewtrusts.org/~/media/assets/2016/02/cb_mobilitypaymentsissuebrief.pdf.
[18] The Pew Charitable Trusts, "Who Uses Mobile Payments? Survey Findings on Consumer Opinions, Experiences," (May 2016), http://www.pewtrusts.org/~/media/assets/2016/05/who_uses_mobile_payments.pdf.

<u>Memorandum: "PTI-Plus" Factors for Small-Dollar Loans</u>
September 23, 2015

As part of their framework for regulating payday and similar loans, the CFPB has proposed a streamlined underwriting option that would allow banks to originate small loans that comply with the following safeguards: a monthly payment equal to or less than 5% of the borrower's monthly income, and a maximum repayment term of six months.

OCC staff have indicated an interest in new forms of small credit options for bank customers, but would also like to ensure that banks do not automatically provide loans without taking steps to screen out those who do not have accounts in good standing or who are clearly incapable of managing additional debt. Therefore, the question arises as to what "plus" factors banks could reasonably evaluate before originating loans pursuant to the CFPB's 5% payment / 6-month alternative.

Accordingly, what follows is an initial list of ideas. Ideally, the bank's evaluation process would not add substantially to the cost of the loan, or the time required to originate the loan, and would be consistent with some kind of prescreening process so that customers could be reasonably assured of getting the loan if they request one (since risk of being declined by the bank or having to fill out forms are major factors in driving customers to payday lenders). At the same time, the evaluation process should be consistent with principles of sound lending practices, and product features should be designed in a way that avoids hidden costs, frequent refinancing, or other potentially harmful practices.

<u>Account in good standing</u>
The bank will make loans only to customers with established accounts that are in good standing, and will not offer loans where certain common signs of financial distress exist. Based on this customer's relationship with this bank:

- Minimum relationship of 3 months
- Not a serial overdrafter
    - Bank may create its own reasonable definition. It may be something like no more than 3 overdraft occurrences (i.e., days) in the past month
- Evidence of recurring deposits with this bank
    - Direct deposit or steady non-direct deposits
- No charge-offs with this bank in past 3 months
- No accounts currently subject to a bankruptcy proceeding with this bank

<u>Reasonable product safeguards in place</u>

- Reduce overdraft shadow limit by amount of this loan
- Payments on this loan may not trigger overdraft or NSF fees with this bank
    - Or, payments on this loan cannot take checking account balance negative
- Only one of these loans outstanding with this bank at a time

    - Possibly add: All ATM overdrafts must be turned off on customer's checking account with this bank while a loan is outstanding (because these loans are similar to ATM overdraft)
- Origination and Penalty Fees – *Details TBD still*
    - In principle, no more than a de minimis level of portfolio revenue should come from penalty fee income. Possibly prohibit late fees or cap at a low amount and/or maximum number of fees per loan. *Pew suggests it would be reasonable to cap late fees at $5 chargeable no more than once per month.*
    - Origination fees create risk of "loan flipping" – *TBD what if any guideline should apply here; Pew suggests requiring a "simple" fee structure as demonstrated, e.g., by having no fees possible on the loan other than a monthly fee earned at the start of each month the loan is outstanding, with the possible exception of a late fee as explained above.*

- *Note yet discussed:* The total amount of credit extended must not exceed 25% of the customer's average monthly deposits over the prior month (three months?), or more than one week of average weekly deposits

<u>Consumer financial health</u>
- Positive loan performance should be reported to a credit bureau
- Bank should take reasonable steps to migrate customers who successfully repay these loans to mainstream credit products as soon as feasible, and should provide customers with clear and concise information about how they can achieve access to more mainstream credit opportunities.

Office of the Chief Economist Research Note

Trends and Estimates of Consumer Savings from Payday Alternative Loan Programs

April 29, 2015

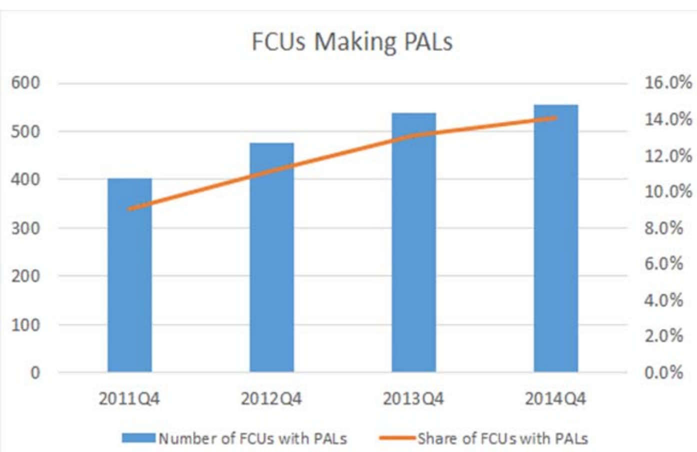
Payday Alternative Loans (PALs), also known as short-term, small amount loans (STS), compete with payday loans provided by non-banks and deposit advance products offered by some banks. PALs generally are far more affordable and have much better product features than the alternatives.

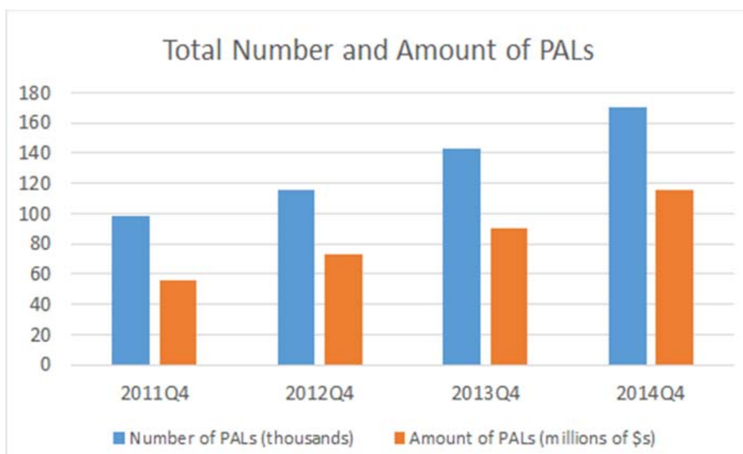
PALs Overview:

Aggregate Analysis

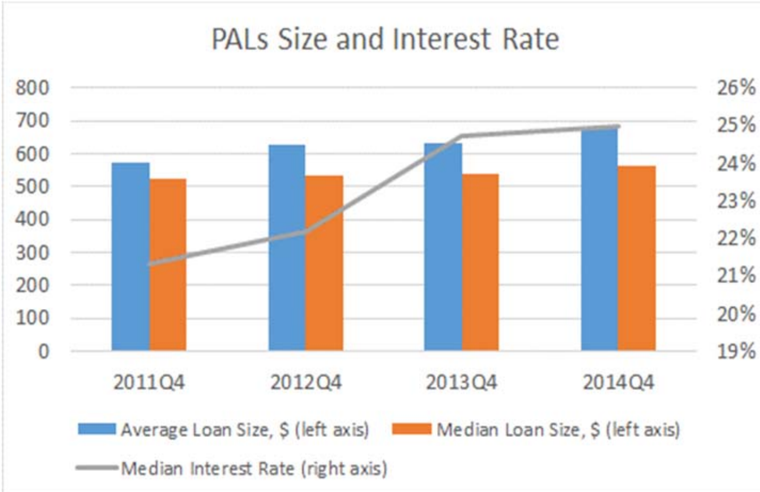
NCUA collects call report data on PALs starting in 2010Q4, when the Agency commenced this program for federal credit unions. The analysis below uses data starting in 2011, the first full year of this program. Because PALs are short-term, the activity is best captured using the year-to-date flow of loans rather than the stock of loans on the balance sheet at a given point in time. “Data Source and Methodology” section of the Appendix describes our methodology and data availability.

As charts below demonstrate, number and share of federal credit unions (FCUs) making PALs increased from 403 in 2011 to 554 in 2014, a 37% increase. The share of total FCUs these FCUs represent increased from 9.1% in 2011 to 14.1% in 2014. Total number and amount of PALs originated also rose in the past three years. PALs originated increased from about 98 thousand in 2011 to 170 thousand in 2014. In dollar volume, these loans totaled about $56 million in 2011 and $115 million in 2014.





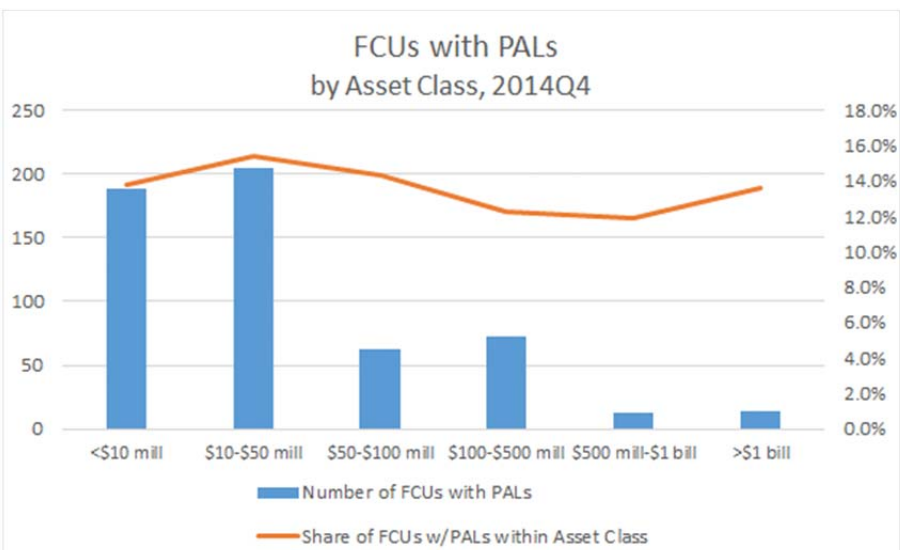
Average PAL size increased from $571 in 2011 to $678 in 2014, while the median rose from $524 to $563 during that time. The median interest rate increased from 21.3% in 2011 to 25.0% in 2014.



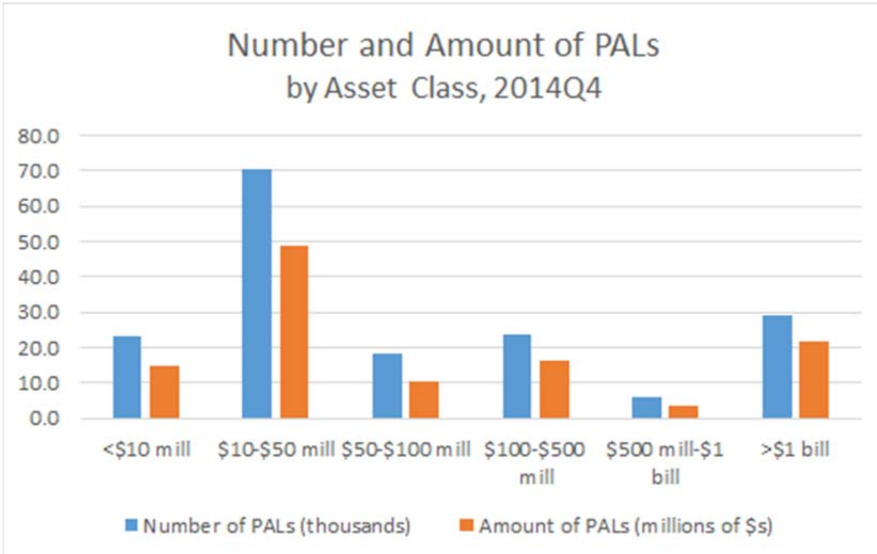
PALs by Asset Class

Charts below analyze PALs by asset class. In 2014, 14.1% of all FCUs were making PALs, an increase from 9.1% in 2011. FCUs with total assets of between $10 and $50 million dollars had the highest share in 2014, at 15.4%, while FCUs with total assets of $500 million to $1 billion had the lowest share, at 11.9%.

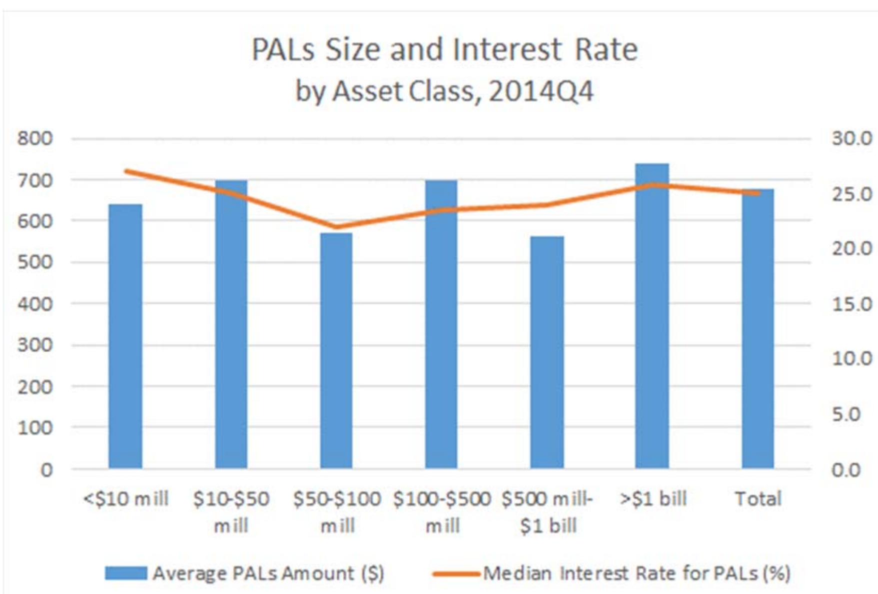
Compared to 2011, FCUs with less than $10 million in assets experienced the largest increase among those with PALs. Their share increased from 7.7% in 2011 to 13.8% in 2014. The smallest increase was in the $100 million to $500 million asset class, with the share of FCUs with PALs increasing from 9.9% to 12.2% from 2011 to 2014.



About 70 thousand or 41% of 170 thousand PALs made in 2014 were made by FCUs with $10 million to $50 million in total assets. FCUs in that asset category also account for the largest share of total PALs dollar volume, with about $49 million dollars of PALs originated in 2014, accounting for 42% of total PALs dollar volume that year.



Average loan size and median interest rate also vary by asset size.[1] In 2014, FCUs with assets of more than $1 billion originated the largest PALs, with the average size of $740. In contrast, FCUs with $500 million to $1 billion in assets originated PALs with the smallest average size ($563). FICUs with assets of less than $10 million charged the highest median interest rate on their PALs in 2014 (27.0%), while FCUs with assets between $50 and $100 million charged the lowest median interest rate (21.9%) during that time. The average loan size of all FCU-originated PALs in 2014 was $678 and the median interest rate was 25.0%.



[1] Medians include imputed interest rates. See "Data Sources and Methodology" section in Appendix for explanation of our methodology.

PALs Program Features

In order to increase success of PALs programs, NCUA encourages credit unions that offer PALs to include a saving component, financial education, reporting of payments to credit bureaus, electronic loan transactions, and incentivized utilization of payroll deductions.

NCUA profile form collects information on provisioning of four of these features as a condition to obtaining PALs (all but electronic loan transactions). Analysis below shows how many FCUs that offer PALs also have these conditions in place.

In 2014Q4, 74% of FCUs that made PALs had credit bureau reporting of PALs payments as a condition for providing a PAL. Sixty-nine percent reported having payroll deduction as such a feature, while 38% and 19%, respectively, reported requiring financial education and a savings component.

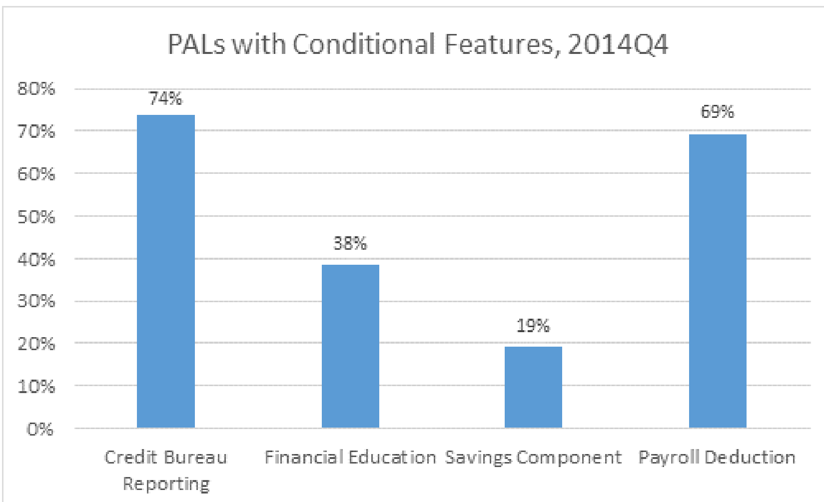


Table 1 below shows the use of conditional services by asset class. Credit bureau reporting of PALs payments and a requirement of financial education are most prevalent among FCUs with more than $1 billion in assets. Almost 86% and 57% of FCUs in that asset class that originated PALs in 2014 had those two conditions in place. Savings component is most prevalent among FCUs with $50 million to $100 million in assets (33%), while payroll deductions are most prevalent in FCUs with less than or equal to $100 million in assets (over 69%).

Table 1

FCUs with PALs and Conditional Services, 2014Q4

	Number of FCUs with PALs with:				Within Asset Class Share (%) of FCUs with PALs with:			
Asset Class	Credit Bureau Reporting	Financial Education	Savings Component	Payroll Deduction	Credit Bureau Reporting	Financial Education	Savings Component	Payroll Deduction
<$10 mill	120	54	30	132	63.8	28.7	16.0	70.2
$10-$50 mill	164	79	36	158	80.0	38.5	17.6	77.1
$50-$100 mill	49	28	21	44	77.8	44.4	33.3	69.8
$100-$500 mill	56	40	16	40	77.8	55.6	22.2	55.6
$500 mill-$1 bill	8	4	0	5	66.7	33.3	0.0	41.7
>$1 bill	12	8	3	5	85.7	57.1	21.4	35.7
Total	409	213	106	384	73.8	38.4	19.1	69.3

Delinquency and Charge Offs

Table 2 below includes information on aggregate delinquency and charge off rates on PALs, by quarter. Delinquency for this analysis is calculated based on loan portfolios at a point-in-time rather than the year-to-date lending activity. To evaluate PALs delinquency, NCUA gathers data that represents PALs on the credit union's balance sheet as of quarter-end. These loans may include PALs activity from the prior year. Of the 537 FCUs that carried PALs on their balance sheets as of the end of 2014Q4, 277 indicated reportable delinquency and 333 reportable charge-offs. Table 6 in Appendix shows these numbers for other quarters.
This metric shows that aggregate delinquency rate on PALs has been rising, as volume increased, but started to subside recently. Aggregate delinquency rate declined to 2.80% in 2014Q4 after peaking at 3.64% during 2014Q1. Aggregate annualized net charge-off rate as a share of average PALs was 7.52% in 2014Q4, a decline from the 2014Q3 peak of 7.76%.

It is important to note, however, that stock data collected at the end of each quarter makes it difficult to evaluate actual PALs delinquency, due to the very short nature of these loans. To better understand delinquency behavior on these loans, we look at charge off rates using year-to-date metrics (not available for PALs delinquency). Table 3 below, shows aggregate net charge off rates, using year-to-date charge off and PALs information. Using these metrics, aggregate net charge off rate was 2.08% in 2014Q4.

Table 2

Delinquency and Charge Off Rates on PALs, using stock data

Quarter	Aggregate Delinquency Rate, %	Aggregate Net Charge Off Rate*, %
2011.4	1.97	4.31
2012.1	2.33	5.83
2012.2	2.01	5.56
2012.3	2.52	5.49
2012.4	2.21	5.52
2013.1	2.41	7.58
2013.2	2.25	6.86
2013.3	3.30	6.11
2013.4	3.18	6.56
2014.1	3.64	7.55
2014.2	2.74	7.49
2014.3	2.99	7.76
2014.4	2.80	7.52

*Annualized share of average loans

Table 3

Charge Off Rate on PALs, YTD

Quarter	Aggregate Net Charge Off Rate, %
2011.4	1.22
2012.1	1.77
2012.2	1.56
2012.3	1.27
2012.4	1.51
2013.1	2.18
2013.2	1.75
2013.3	1.57
2013.4	1.75
2014.1	2.03
2014.2	2.00
2014.3	2.05
2014.4	2.08

Appendix[2]

Data Sources and Methodology:

This analysis used 5300 Call Report and Profile Form data associated with NCUA's 2014Q4 quarterly data release. The data was extracted from the agency's ReportDatabaseArchived (i.e., stable) server.

<u>Identifying credit unions with PALs (STS) activity:</u>

The Call Report collects STS loan count and dollar volume data to measure the credit union's activity in two dimensions: cumulative year-to-date lending, and stock of loans as of quarter-end. Since STS loans are short-term, a credit union's lending volume is more accurately captured using year-to-date rather than point-in-time data.

We used two variables from the 5300 Call Report to identify federal credit unions engaged in payday alternative loan (PALs) lending activity:

Number of STS loans granted year-to-date (acct_031c)
Amount of STS loans granted year-to-date (acct_031d).

Credit unions reported both fields; we found no instances of partial reporting where CUs reported only one of the two variables. We did not recode either of these fields.

The Profile Form's Credit Union Programs and Member Services section contains two variables that indicate credit union provision of products:

Credit Union Programs: Short-Term, Small Amount Loans (FCU Only)
Member Service and Product Offerings: Credit: Pay Day Loans.

For federally insured, state chartered credit unions (FISCUs), the pay day loan variable is the only way to identify similar short-term lending. Since this report focuses on FCUs, we opted to use the Call Report's YTD variables instead of the Profile Form because they provide the most precise measures of STS lending activity.

<u>Modifying the STS interest rate:</u>

Credit unions are also required to report the STS loan interest rate offered as of the reporting period. If more than one rate was in effect, credit unions are instructed to report the most common rate. This variable is located in the Call Report's assets section, next to the balance sheet's stock of STS loans. NCUA's database stores the interest rate in basis points (e.g., 12.0% stored as 1200).

We identified three reporting patterns that required recoding the STS interest rate. In all three instances we adopted a conservative approach to both identifying and imputing outliers. However, we addressed only the most obvious anomalies, and a more in-depth examination of the STS interest rates is needed to assess data quality.

It is important to note that we used the recoded STS loan interest rate variable throughout the report, so all references to the median interest rate include revised data.

[2] In this section, we refer to PALs by their FPR name: STS (short-term, small amount loans).

Table 4
Recoding the STS loan interest rate (acct_522a)

	Reporting pattern	Treatment
A	Credit union reports no STS YTD lending activity, but a non-zero interest rate.	Reset STS interest rate to zero. Assume CU has no STS YTD lending activity.
B	Credit union reports STS YTD lending activity, but a zero interest rate.	Reset STS interest rate to 28.0%, the regulatory maximum.
C	Credit union reports STS YTD lending activity, but interest rate is an outlier.	Reset reported interest rate if less than 100 basis points (1%): Multiply STS interest rate by 100 if the reported rate is greater than zero AND less than 100.

The following table shows the frequency of STS interest rate recoding by quarter:

Table 5

Quarter	Number of FCUs reporting STS interest rate, but no YTD activity: Reset IR to zero (Recode A)	Number of FCUs with STS YTD activity not reporting interest rate: Reset IR to 28% (Recode B)	Number of FCUs with STS YTD activity, reporting interest rate less than 100 bps: Rescaled IR (Recode C)
2010q4	13	19	0
2011q1	24	14	0
2011q2	13	20	0
2011q3	10	15	1
2011q4	5	23	0
2012q1	29	13	0
2012q2	21	20	0
2012q3	11	19	1
2012q4	8	26	2
2013q1	39	12	0
2013q2	15	23	1
2013q3	12	25	1
2013q4	7	31	0
2014q1	55	11	0
2014q2	19	12	0
2014q3	17	19	0
2014q4	10	27	1

Count of FCUs with reportable delinquency and charge offs by quarter:

Table 6

FCUs with a Non-Zero PAL Balances, Delinquency, and Charge Offs

Qaurter	Loans >$0	Delinquency >$0	Net Charge Offs* > $0
2011.4	388	154	174
2012.1	386	158	136
2012.2	418	161	179
2012.3	431	180	209
2012.4	457	190	233
2013.1	465	179	175
2013.2	488	197	216
2013.3	506	227	251
2013.4	515	235	293
2014.1	515	228	220
2014.2	540	240	268
2014.3	541	250	300
2014.4	537	277	333

*Annualized Share of Average STS Loans. Note: some FCUs report net charge offs with $0 PAL balance

Codebook:

Table 7

STS Variables in NCUA 5300 Call Report

Form	Variable Name	Description	Universe	Collection periods
5300	522a	STS loans: Interest rate as of quarter-end	FCUs	2010q4- current
5300	994a	STS loans: # of loans as of quarter-end	FCUs	2010q4-current
5300	397a	STS loans: Dollar volume as of quarter-end	FCUs	2010q4-current
5300	031c	STS loans: # of loans YTD	FCUs	2010q4-current
5300	031d	STS loans: dollar volume YTD	FCUs	2010q4-current
5300	136	STS loans: Charge-offs	FCUs	2010q4-current
5300	137	STS loans: Recoveries	FCUs	2010q4-current
		STS loans: Delinquency - # of loans		
5300	089a	30-59 days	FCUs	2010q4-current
5300	127a	60-179 days	FCUs	2010q4-current
5300	128a	180-359 days	FCUs	2010q4-current
5300	129a	>=360 days	FCUs	2010q4-current
5300	130a	Total number of reportable delinquent loans (>=60 days)	FCUs	2010q4-current
		STS loans: Delinquency - dollar volume		
5300	089b	30-59 days	FCUs	2010q4-current
5300	127b	60-179 days	FCUs	2010q4-current
5300	128b	180-359 days	FCUs	2010q4-current
5300	129b	>=360 days	FCUs	2010q4-current
5300	130b	Total amount of reportable delinquent loans (>=60 days)	FCUs	2010q4-current