

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Part 701**

**RIN 3133-AD71**

**Short-Term, Small Amount Loans**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Proposed rule.

**SUMMARY:** NCUA proposes to amend its general lending rule to enable federal credit unions (FCUs) to offer short-term, small amount loans (STS loans) as a viable alternative to predatory payday loans. The proposed amendment would permit FCUs to charge a higher interest rate for an STS loan than is permitted under the general lending rule, but the proposal will impose limitations on the permissible term, amount, and fees associated with an STS loan. The STS loan alternative will assist FCUs in meeting their mission to promote thrift and meet their members' credit needs, particularly the provident needs of members of modest means. Permitting a higher interest rate for STS loans will permit FCUs

to make loans cost effective while the limitations on the term, amount, and fees will appropriately limit the product to meeting its purpose as an alternative to predatory credit products. This rule also identifies “best practices” FCUs should incorporate into their individual STS programs.

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

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

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

**Public inspection:** All public comments are available on the agency’s website at <http://www.ncua.gov/RegulationsOpinionsLaws/comments> as submitted,

except as may not be possible for technical reasons. Public comments will not be edited to remove any identifying or contact information. Paper copies of comments may be inspected in NCUA's law library, at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to [OGCMail@ncua.gov](mailto:OGCMail@ncua.gov).

**FOR FURTHER INFORMATION CONTACT:** Justin M. Anderson, Staff Attorney, Office of General Counsel, at the above address or telephone (703) 518-6540.

## **SUPPLEMENTARY INFORMATION.**

### **A. Background**

NCUA proposes to amend its general lending rule to provide a regulatory framework so FCUs can be a viable alternative to high-cost payday lenders. The term “payday loan” generally refers to a small, short-term loan that is intended, specifically, to cover a borrower's expenses until his or her next payday, when the loan is to be repaid in full. NCUA Instruction 10200, Credit Union Online Instruction Guide, page 32 (12/2009). Historically, these loans have often been made by lenders who charge high fees and sometimes engage in predatory lending practices. While some payday loan borrowers use these loans sparingly, many other borrowers find themselves in cycles where their loans “roll over” repeatedly, incurring even higher fees. These borrowers are often unable to

break free of this unhealthy dependence on payday loans. The NCUA Board (the Board) believes this dependence often reflects or exacerbates other financial difficulties payday loan borrowers are experiencing. The Board believes that, under the proper regulatory framework, FCUs can offer their members a reasonable alternative to high-cost payday loans and be a source of fair credit.

The Board believes this proposed rule would achieve short and long-term benefits for current payday borrowers. In the short-term, this proposed rule would provide borrowers with a responsible alternative to high-cost payday loans; in the long-term, the Board believes this rule will permit FCUs to offer borrowers a way to break the cycle of reliance on payday loans by building credit and converting to traditional, main-stream financial products. Unlike payday lenders, which rarely report their customers' payment of loans to credit bureaus, FCUs will generally be reporting their members' payment histories with STS loans to the credit bureaus. Members who successfully pay off STS loans at FCUs will likely be able to improve their credit scores and qualify for future loans at lower costs.

NCUA's 5300 Call Report data, for the time period ending December 31, 2009, indicate that approximately 352 FCUs currently offer various types of payday loan alternatives, and approximately 605 FCUs currently offer micro loans, which are loans with a principal under \$500. The products currently being offered by FCUs include a mix of open and closed-end loans. With regard to open-end products, the Board notes this proposal does not address or alter the applicable

regulations governing these products and does not prohibit open-end programs that are currently permissible. In addition, this proposed rule would not prohibit an FCU from continuing or participating in a closed-end payday loan program that currently operates successfully and is legal under NCUA's regulations and the Federal Reserve Board's Regulation Z (Reg Z). 12 CFR Part 226.

As evidenced by the small number of FCUs currently offering payday loan alternatives, the Board recognizes the current legal framework makes it difficult for FCUs to establish a safe and sound STS loan program for closed-end loans that satisfies the legal requirements of NCUA's regulations and the Federal Credit Union Act (the Act). For example, the Board notes some FCUs have charged high "application" fees to offset the risk of STS loans and remain under the current interest rate ceiling. These high fees, however, may be contrary to FCUs providing members with a better alternative to high-cost payday loans. Also, application fees that exceed the cost of processing the application may be deemed finance charges under Reg Z and result in an FCU violating NCUA's interest rate ceiling.

## **B. Legal Framework**

While the Act permits FCUs to make loans and extend lines of credit to members, it prohibits FCUs from charging an annual percentage rate (APR), inclusive of all finance charges, above 15%. 12 U.S.C. 1757(5)(A)(vi). The Act, however, permits the Board, after considering certain statutory criteria, to

establish a higher interest rate ceiling in 18-month cycles. *Id.* At its July 2009 meeting, the Board reapproved an APR ceiling of 18%, effective until January 2011. NCUA Letter to Federal Credit Unions 09-FCU-06 (July 2009).

NCUA's long-standing policy has been to look to the definition of "finance charge" in Reg Z to determine what fees are finance charges. The NCUA Board articulated this policy in the preamble of a final rulemaking, and the Office of General Counsel has subsequently reiterated the policy in numerous legal opinions. 45 FR 22888, 22890 (April 4, 1980); OGC Op. 91-0412 (April 30, 1991); OGC Op. 03-1050 (November 10, 2003).

Reg Z defines "finance charge" broadly as including "any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." 12 CFR §226.4(a). As a result, most fees charged in connection with an extension of credit are considered finance charges.

Reg Z, however, expressly excludes certain charges from the definition of finance charge. Relevant to this proposed rule, Reg Z excludes "[a]pplication fees charged to all applicants for credit, whether or not credit is actually extended." 12 CFR §226.4(a). The Official Staff Interpretations to Reg Z further explains:

An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans, However (*sic*), if the fee is to be excluded from the finance charge under § 226.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.

12 CFR Part 226, Supp. I, Section 226.4—Finance Charge, 4(c) Charges excluded from the finance charge. Paragraph 4(c)(1).

To provide more flexibility for STS loans, the Board considered changing NCUA's long-standing policy of looking to Reg Z in defining finance charge. The Board, however, has determined that a consistent interpretation of finance charge, in line with requirements for other lenders, will be more easily understood by members and FCUs.<sup>1</sup> The Board, therefore, is proposing to amend NCUA's general lending rule by permitting a separate and higher interest rate ceiling for STS loans. The Board notes this proposed rule prohibits FCUs making loans using the higher interest rate ceiling from charging any fees in excess of a capped application fee and restricts the duration and amount of STS loans.

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<sup>1</sup> The Board notes the Fed has proposed a rule that would remove most finance charge exclusions for closed-end credit transactions secured by real property or a dwelling. The Fed's proposed rule solicited public comment on whether to expand this provision to encompass all closed-end transactions. Truth in Lending, 74 FR 43232 (August 26, 2009). The comment period closed in December of 2009, and, if the Fed amends the definition of finance charges for all closed-end transactions, the Board will consider revising the requirements of this proposal.

## **C. Proposed Changes**

### **1. Interest Rate Ceiling**

Payday lenders often charge APRs in excess of 400%. Without an increase in NCUA's allowable APR for STS loans, the Board believes it may be almost impossible for some FCUs to provide these types of loans to members. The Board believes small FCUs in particular, which often have members in need of this type of loan, would not be able to operate an STS loan program under NCUA's current interest rate ceiling in a cost-effective manner.

Historically, the Board has had one interest rate ceiling for lending, which has ranged between 15% and 21%. The Board does not believe it is necessary to raise the interest rate ceiling for all credit products. Rather, the Board's authority to establish a higher interest rate than set by the Act encompasses authority, once the statutory criteria are met, to establish different rates for different products. The Board, therefore, proposes to set a higher interest rate ceiling only for STS loans made in accordance with the proposed requirements of this rule.

The Board believes an annual percentage rate (APR) of 1000 basis points above the established general interest rate ceiling, as set by the Board, is sufficient for FCUs to offer STS loans with a reasonable return considering they are unsecured and have a high risk of loss. Based on the current interest rate ceiling, the maximum APR under this proposed rule would be 28%. This figure is lower than the maximum permissible interest rate under both the Talent

Amendment, Public Law 109–364, § 670, 120 Stat. 2266 (2006) (codified at 10 U.S.C. 987), and the FDIC’s Small-Dollar Loan Pilot Program Guidelines (SDLG).<sup>2</sup>

In determining an APR ceiling for STS loans, the Board examined data collected by the FDIC during the first year of its pilot program and determined an APR that averaged the maximum APR and the average APR offered by banks under the program was an appropriate figure for FCUs.<sup>3</sup> In addition to accounting for the not-for-profit nature of FCUs, a 28% APR also takes into account that the APR under both the Talent Amendment<sup>4</sup> and the FDIC’s SDLG is inclusive of all fees, while this proposed rule permits a capped application fee in addition to the set APR. The APR ceiling in this proposed rule also considers the average usury caps and payday loan laws enacted by several states.<sup>5</sup>

The Board realizes that interest income alone may not be sufficient to recover losses and the costs of processing an application, and, therefore, is proposing

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<sup>2</sup> In 2007, the FDIC implemented a voluntary pilot program to assess the viability of banks offering short-term loans. The FDIC’s SDLG provided for a maximum APR of 36%, inclusive of all fees, and issued guidelines for a bank to participate in the program. Federal Deposit Insurance Company, Final Guidelines for Affordable Small-Dollar Loans, PR-52-2007 (2007).

<sup>3</sup> In the fourth quarter of the FDIC’s pilot program, the average APR was 20% and the maximum APR was 35.5%. The average of these two figures is 27.75%. The FDIC’s Small-Dollar Loan Pilot Program: A Case Study After One Year, FDIC Quarterly, Volume 3, No. 2 (2009)

<sup>4</sup> The Department of Defense regulations implementing the Talent Amendment permit a 36% APR inclusive all fees associated with extension of credit to a covered borrower if they are financed, deducted from the proceeds of the consumer credit, or otherwise paid as a condition of the credit. 72 FR 50592 (August 31, 2007). For additional discussion of issues regarding implementation and oversight of the regulation see Department of Defense Report to the U.S. Senate on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents (2008) at <http://www.dcuc.org/PDF%20Files/Senate%20Report%20Final.pdf>.

<sup>5</sup> Currently, 14 states have usury caps on small-dollar loan products, which have an average rate of 24.2%.

FCUs be permitted to charge a capped application fee as discussed below. The Board, however, is requesting specific 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 this proposed rule. The Board notes that, although this proposed rule allows a higher APR ceiling for STS loans than for all other FCU loans, it encourages FCUs to charge only an APR that allows an STS loan program to operate in a safe and sound manner.<sup>6</sup>

## **2. Application Fees**

The Board recognizes that some payday lenders charge fees, disguised as “application” fees, to account for the risk of loss associated with STS loans. Often these fees exceed \$50 and are sometimes tied to the amount of the loan. As noted above, Reg Z defines an application fee as the fee necessary to recoup actual costs incurred by the lender in reviewing an application. The Board believes it is illegal under the Act and Reg Z for FCUs to link fees to the loan amount or charge application fees this high.

The credit worthiness determination in payday lending scenarios is often minimal, consisting of a verification of employment, age, and residence; sometimes, it is less than that. The Board is proposing to restrict FCUs making STS loans to charging an application fee in accordance with the definition in Reg Z that is no

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<sup>6</sup> See fn. 3. In the FDIC’s pilot program, some participating banks were able to offer loans at an APR less than maximum permissible APR. Federal Deposit Insurance Company, The FDIC’s Small-Dollar Loan Pilot Program: A Case Study after One Year, FDIC Quarterly Vol. 3, no. 2 (2009). The SDLG is located on the FDIC’s website at [www.FDIC.gov/small-dollarloans](http://www.FDIC.gov/small-dollarloans).

more than \$20. Reg Z limits application fees to the recovery of costs associated with processing applications for credit that are charged to all consumers who apply, regardless if credit is actually extended. 12 CFR §226.4(c)(1).

The Board believes that, for FCUs to offer an economically-viable product, they must be permitted to recover the costs associated with processing an application up to a reasonable amount. The Board recognizes STS loans present a higher degree of risk, but it is the interest rate, not the application fee, on which FCUs should rely to address that risk. The Board believes an application fee should recoup the costs associated with processing an application, and FCUs should rely on interest income to account for losses and create a sustainable product. In determining an appropriate maximum application fee, the Board considered the limited underwriting associated with STS loans and the ability of FCUs to process applications efficiently for this product. The Board believes a maximum application fee of \$20 would adequately permit FCUs to recover their processing costs and provide a responsible alternative for members.

### **3. Maturity and Amount**

This proposed rule would also set a minimum and maximum maturity and dollar amount for STS loans. The Board believes it is necessary to specifically establish the terms for this type of loan to ensure FCU members are able to manage repayment.

The Act allows the Board to prescribe rules and regulations regarding how loans are to be repaid.

Loans shall be paid or amortized in accordance with rules and regulations prescribed by the Board after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interest of the members and the credit unions, and such other factors as the Board deems relevant.

12 U.S.C. 1757(5)(A)(ix).

In considering the nature of STS loans, the Board proposes to set the maturity at a minimum of one month and a maximum of six months. Payday loans generally must be repaid within two weeks, regardless of loan amount, often causing borrowers to roll the loans over to avoid default. The proposed rule prohibits “roll-overs,” so FCUs need to set a maturity, within this range, based on the amount of the loan and the borrower’s ability to repay. The Board believes setting a minimum and maximum loan term will make STS loans a better alternative to payday loans.

The Board also proposes setting the amount of a qualifying STS loan at a minimum of \$200 and a maximum of \$1000. The maximum amount is slightly lower than the average loan amount in the FDIC’s pilot program.<sup>7</sup> However, the

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<sup>7</sup> FDIC cites that 26 banks in the pilot program made 4,338 loans with a total principal balance of \$5.2 million. Dividing the total principal balance by the total number of loans equals an approximate average loan of \$1,198.71. Federal Deposit Insurance Company, The FDIC’s Small-Dollar Loan Pilot Program: A Case Study After One Year, FDIC Quarterly Vol3, no. 2 (2009).

Board believes a maximum loan amount of \$1000 will provide borrowers with lending comparable to payday lenders and possibly permit borrowers to pay off current payday loans and transition to more responsible FCU products, helping borrowers to break the payday cycle. Regarding the \$200 minimum loan, the Board believes this minimum is reasonable in terms of the maximum \$20 permissible application fee the rule permits and recognizes there is demand for short-term loans in this amount. Available data suggests the average, traditional payday loan amount is between \$300 and \$400.<sup>8</sup>

This proposed rule would also impose a limit on the number of STS loans an FCU may lend to a member at any one time and on the total number of these loans an FCU may make to a member in any rolling six-month period. Specifically, an FCU would only be permitted to make one loan at a time to a member and no more than three in any rolling six-month period. The proposed rule also prohibits FCUs from granting roll-overs to a borrower. The Board believes these provisions of the rule will work to curtail a member's repetitive use and reliance on this type of product, which often compounds the member's already unstable financial condition. The Board notes that average borrowers use a payday product in excess of eight times per year, most of which are continuous "roll-overs" of an initial loan.<sup>9</sup> The Board recognizes that continuously

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<sup>8</sup> Nancy Pierce, *Payday Lending: The Credit Union Way*, CUNA LENDING COUNCIL & NATIONAL CREDIT UNION FOUNDATION/REAL SOLUTIONS® (2008), available at <http://realsolutions.coop/assets/2008/7/23/NancyPierceCUNALendingCouncilPaydayLendingWhitePaperWithNCUFAndREALSolutions.pdf>

<sup>9</sup> Keith Ernst, John Farris & Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (2003), available at <http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf>.

“rolling-over” a loan can subject a borrower to additional fees and repayment amounts that are substantially more than the initial amount borrowed. The Board believes that this proposed rule offers terms that will eliminate the need for a borrower to roll over a loan.

FCUs should set a loan amount and loan terms based on the borrower’s ability to repay. The Board notes FCUs are not expected to run a credit report on a borrower to determine ability to repay STS loans. Rather, an FCU should be able to use a borrower’s proof of recurring income as the key criterion in developing standards for maturity lengths and loan amounts so a borrower can repay the loan without roll-overs. As noted above, the intent of this rule is to permit FCUs to provide a viable, responsible alternative to high-cost payday loans, which will help members break the cycle, improve their credit scores and gain or re-gain access to mainstream financial products.

This rule does not address charging fees for late payments or defaults in an STS loan program. FCUs can impose late fees that comply with NCUA’s credit practices rule, 12 CFR Part 706. However, FCUs should be careful that late fees do not exacerbate a borrower’s financial situation. FCUs should be careful in setting maturity terms and loan amounts based on a borrower’s proof of recurring income so that borrowers will be able to pay off the loan without incurring late fees.

#### **4. Cap on Loan Volume and Underwriting**

In addition to the requirements relating to making an STS loan, the proposed rule would require FCUs to include, in their written lending policies, a cap on both the total number and total dollar amount of STS loans. The Board is concerned with the inherent higher risk in STS loans, which may be heightened by an initially high loan volume. The Board believes a high, initial loan volume, coupled with likely higher defaults, could stretch resources for collections and expose the FCU to unnecessary risks.

Alternatively, and in order to limit risks on FCUs' balance sheets and to ensure that STS loan volume does not overwhelm FCUs' lending and collections operations, the Board is considering setting a cap in the final rule on the dollar amount, percentage and/or number of STS loans that FCUs can have outstanding at any given time. The Board seeks comments on how such a cap could be structured, for example, as a percentage based on assets or other formula, while meeting the overall objectives of this proposed rule.

Finally, the Board is proposing to require FCUs to implement appropriate underwriting criteria for STS loans to minimize risk. In developing underwriting criteria, an FCU should focus on the member's relationship with the FCU and the borrower's ability to repay the loan at or before maturity. Based on the member's potential ongoing relationship with the FCU and the small-dollar amount of the loan, an FCU may only need to review a member's account records and proof of

recurring income. To verify proof of income, FCUs should require a member to produce at least two recent paycheck stubs. Below, the Board requests specific comment on requiring borrowers to participate in direct deposit or a payroll deduction program as a condition of an extension of credit under this rule, which may assist an FCU in verifying a member's employment status for underwriting purposes. As noted above, however, the Board does not believe it is generally necessary for an FCU's underwriting to include a credit report. The Board believes an FCU's underwriting criteria should address a member's need for quickly available funds but adhere to the principles of responsible lending.

## **5. Guidance and Best Practices**

Although the Board is not proposing specific underwriting standards, risk avoidance methods, or program features, FCUs should consider the "best practices," discussed below, in developing an STS program. The Board believes the proximity of including the "best practices" in the regulatory text will be helpful to FCUs. These practices are not regulatory requirements, but FCUs should consider them in developing an STS program. FCUs should also consider guidance NCUA issued last year on payday alternatives. NCUA Letter to Federal Credit Unions, "Payday Lending" 09-FCU-05 (July 2009) (09-FCU-05) (available on NCUA's website at <http://www.ncua.gov/Resources/09-FCU-05.pdf>). In addition, the Board has reviewed the FDIC's SDLG and notes these guidelines

also offer prudent suggestions for an FCU to consider in developing an STS loan program.<sup>10</sup>

Although STS loan programs can be a useful method of serving members, there are inherent risks in this type of loan. In developing an STS loan program, FCUs should consider the credit, transaction, fraud, reputation, and compliance risks. FCUs should also consider the risks for members of receiving STS loans and try to minimize them. The Board encourages FCUs to use STS loans as a means of serving more members and, through financial counseling and other methods, attempt to help members move away from STS loans in favor of an FCU's more mainstream products and services. See 09-FCU-05. FCUs should also consider offering certain additional features such as a savings component or electronic loan transactions as part of a successful STS program. The Board is also recommending FCUs, at least in the initial stages of an STS loan program, consider a length of membership requirement of at least three months. The Board recognizes there is a higher risk of default among new members as opposed to members with an established relationship with an FCU. The Board is seeking comment on whether a certain length of membership should be required, or whether each FCU should evaluate their own risk tolerance and decide on a membership requirement accordingly. Rather than prescribe specific membership features that must be included in an STS program, this proposed

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<sup>10</sup> The FDIC's SDLG highlights many of the features, including underwriting, that make payday loans attractive to borrowers. Federal Deposit Insurance Company, Final Guidelines for Affordable Small-Dollar Loans, PR-52-2007 (2007).

rule would allow an FCU to make this determination based on its capabilities and the needs of its members.

#### **D. Request for Comments**

In addition to comments on all aspects of this proposed rule, the Board would appreciate specific comments from credit unions currently offering viable small amount loan programs. In drafting a final rule, the Board is interested in learning from the experience credit unions have had in operating a successful program and the specific features that have led to a program's success as a sustainable and responsible alternative to payday lending. Also, the Board would appreciate comments on certain alternative provisions or requirements that agency staff considered in drafting the proposed rule.

The Board is interested in comments on whether the final rule should require amortization and prohibit balloon payments on STS loans. The Board is concerned that requiring a member to pay back the entire amount or a substantial portion of an STS loan in one payment may not be feasible for some borrowers and may exacerbate a borrower's weak financial situation. The Board is also concerned that STS loans with balloon payments may cause additional financial problems for borrowers or lead them to return to payday lenders.

Another alternative on which the Board requests comments is whether the final rule should set a 36% APR ceiling inclusive of all fees, either in addition to or in

lieu of the maximum APR and application fee terms in the proposed regulatory text. The Board notes an all-inclusive APR would not include fees for unanticipated late payments, defaults, delinquencies, or similar occurrences. As noted above, a 36% APR ceiling, inclusive of all fees, would track the approaches of the FDIC in its pilot program and the Department of Defense regulations. Under the proposed rule, it may be difficult for FCUs to offer STS loans to military borrowers in accordance with the Department of Defense regulations.

Finally, the Board requests comments on whether the final rule should require borrowers to participate in direct deposit or a payroll deduction program as a condition of obtaining an STS loan. Direct deposit is the electronic deposit of funds into a member's account, while a payroll deduction program is an automatic deduction from a member's salary before it is deposited in the member's account. Direct deposit and payroll deduction are useful tools in managing an FCU's exposure. Specifically, both direct deposit and payroll deduction can help an FCU verify employment and income levels of a borrower and help determine the appropriate loan term and amount. In addition, direct deposit helps to ensure there is a recurring source of income, which an FCU may be able to use to recoup a defaulted loan. Further, a payroll deduction program provides FCUs with an easy way to ensure payment is made.

## **REGULATORY PROCEDURES**

### Regulatory Flexibility Act

The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small credit unions (those under \$10 million in assets). This proposed rule increases the interest rate ceiling for STS loans and sets out several STS loan program requirements an FCU must meet to take advantage of the higher interest rates. The proposed rule will not have a significant economic impact on a substantial number of small credit unions, and, therefore, a regulatory flexibility analysis is not required.

### Paperwork Reduction Act

This rule adds a requirement that federal credit unions establish a cap on short-term, small-dollar loans in their general written lending policies, which federal credit unions are already required to maintain and is currently approved under the Paperwork Reduction Act control number 3133-0139. NCUA has determined that the requirements of this rule are additions to an FCU's customary business records and do not increase the paperwork requirements under the Paperwork Reduction Act of 1995 and regulations of the Office of Management and Budget.

### Executive Order 13132

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

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

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

### **List of Subjects**

#### **12 CFR part 701**

Credit unions, Federal credit unions

By the National Credit Union Administration Board on.

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Mary Rupp

Secretary of the Board

For the reasons discussed above, the National Credit Union Administration proposes to amend 12 CFR §701.21(c)(7) as set forth below:

**PART 701 – ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS**

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

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

In section 701.21(c)(7), add new subsection (iii) to read as follows:

**§701.21 Loans to members and lines of credit to members**

\* \* \* \* \*

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Short-term, small amount Loans (STS loans). (A) Notwithstanding the provisions in §701.21(c)(7)(ii), a federal credit union may charge an interest rate of 1000 basis points above the maximum interest rate as established by the Board, provided the federal credit union is making a closed-end loan in accordance with the following conditions:

- (1) The principal of the loan is not less than \$200 or more than \$1000;
- (2) The loan has a minimum maturity term of one month and a maximum maturity term of six months;
- (3) The federal credit union does not make more than three, STS loans in any rolling six-month period to any one borrower and makes no more than one, short-term, small amount loan at a time to a borrower;
- (4) The federal credit union must not roll-over any STS loan;
- (5) The federal credit union charges an application fee to all members applying for a new loan that reflects the actual costs associated with processing the application, but in no case may the application fee exceed \$20; and
- (6) The federal credit union includes, in its written lending policies, a limit on the aggregate number of loans and aggregate dollar amount of loans made under this section and implements appropriate underwriting guidelines to minimize risk; for example, requiring a borrower to verify employment by producing at least two recent pay stubs.

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

(1) Program Features. Several features that may increase the success of an STS loan program and enhance member benefit include adding a savings component, financial education, reporting of members' payment of STS loans to credit bureaus, or electronic loan transactions as part of an STS program.

(2) Underwriting. Federal credit unions need to develop minimum underwriting standards that account for a member's need for quickly available funds, while adhering to principles of responsible lending. Underwriting standards should address required documentation for proof of employment or income, including at least two recent paycheck stubs. FCUs should be able to use a borrower's proof of recurring income as the key criterion in developing standards for maturity lengths and loan amounts so a borrower can repay the loan without roll-overs. For members with established accounts, FCUs should only need to review a member's account records and proof of recurring income or employment.

(3) Risk Avoidance. Federal credit unions need to consider risk avoidance strategies, including: imposing a length of membership requirement,

requiring members to participate in a payroll deduct program or direct deposit,  
and conducting a thorough evaluation of the federal credit unions resources and  
ability to engage in an STS loan program.