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Informs Compliance Digest

Short Term Small Loan Amounts

Digest Number 14

The NCUA Board has amended its general lending rule to enable FCUs to provide members a viable alternative to predatory payday loans. The Short Term Small Amount (STS) Loans can be found in NCUA Regs, Part 701.21 (c) (7) (iii) and effective October 25, 2010.

What does the new rule allow?

- Small loans of $200-to-$1,000 to borrowers who have been members for at least 1 month;
- Short terms of 1-to-6 months;
- Application fee up to $20;
- No rollovers;
- The interest rate that may be charged is up to a 1000 basis points above the maximum set by the NCUA Board **up to 28% APR** if FCUs meet all of the above conditions.

Why offer alternatives to payday loans?
The NCUA Board believes the new short-term small loan rule provides the regulatory framework for FCUs to offer members a reasonable alternative to high-cost payday loans. This allows credit unions to help members break free of exorbitant charges from others.

Will this rule prohibit FCUs from participating in other types of short-term, small lending programs?
No. FCUs may participate in any program that provides loans in accordance with the interest rate ceiling, Regulation Z, and all other applicable laws and regulations.

Can short-term small loans be extended?
While the new rule specifically prohibits roll-overs, FCUs are permitted to extend the term of a short-term small loan, within the 6-month limit set by this rule, as long as the FCU does not charge any additional fees (other than interest) or extend any additional funds.

Will FCUs be able to offer short-term small loans to members of the military?
Yes, FCUs wanting to offer short-term small loans to members of the military, therefore, can permissibly structure their short-term small loan programs so as to not have to comply with the DOD regulations.

Must the loan be amortized, or can the borrower make a balloon payment at the end of the loan term?
The loan must be amortized in such a way that allows the borrower to repay the loan in the given term. While NCUA is not prescribing specific payment schedules (such as monthly or bi-weekly), FCUs should offer payment schedules that allow borrowers to easily repay the loan within the given term.

May multiple loans be made to a borrower?
No. FCUs may make only 1 loan at a time to a member and no more than three loans in any rolling six-month period. The intent is to prevent members from becoming over-extended.

What can the application fee cover?

FCU's application fee can only be the amount needed to recoup the actual costs associated with processing an application, with a maximum amount of $20 which is the same definition outlined in REG Z.

Are FCUs required to charge an application fee?
No. This new rule does not require FCUs to charge any application fee.

Does the provision that allows only application fees prohibit an FCU from charging late fees?
No. FCUs may charge late fees provided the fees are in accordance with all applicable laws and regulations.

What is the membership requirement for a short-term small loan?
30 days. FCUs are encouraged to evaluate risk tolerance and set membership requirements accordingly.

Is there an aggregate lending cap on short-term small loans?
FCUs offering short-term small loans are required to establish a lending cap in their written lending policies on the aggregate dollar amount of short-term small loans outstanding, not to exceed 20% of the credit union's total net worth.

Can payroll deduction be <u>required</u> for the short-term small loan program?
No. The Federal Reserve Board's Regulation E prohibits financial institutions, including FCUs, from conditioning an extension of credit to a member on the member's repayment by preauthorized electronic fund transfers. The NCUA Board encourages FCUs to incentivize or otherwise encourage members to utilize payroll deduction if it is available through the member's employer.

What underwriting standards are required for short-term small loans?
FCUs are required to establish underwriting standards in their written lending policies for short-term small loans. Guidance on how to structure underwriting for short-term small loans is included in the Best Practices section of the NCUA rule which include: a savings component, education, credit reporting, loan payment transfer encouragement, verification of pay stubs (last two), member account history, and proof of recurring income.

What will NCUA examiners review during examination of short-term small loan programs?
Examiners will review the written short-term small amount lending policy as well as the FCU's policies, procedures and processes to determine whether:

- Proper underwriting standards have been established and are being followed;
- Loans are being made in a way that provides the member with the best chance to successfully repay a loan made under this rule;
- Application fees are being used to recoup costs associated with processing an application and not to account for the riskier nature of this type of lending;
- A lending cap has been established to limit the aggregate dollar amount of short-term small loans to a maximum of 20% of net worth.

If you have any questions about this final rule empowering federal credit unions to offer short-term small loans as a viable alternative to predatory payday loans, please contact your CONMAR compliance experts at (800) 227-4931.

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