DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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FEDERAL REGULATORS TAKE STEPS TO ENCOURAGE SMALL-DOLLAR CONSUMER AND BUSINESS LENDING

On May 20th, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board and the National Credit Union Administration jointly published lending guidance to encourage supervised financial institutions to offer responsible small-dollar loans for both consumer and small business purposes. In the guidance, the federal regulators recognized (i) the important role that small-dollar loans can play to help customers' ongoing funding needs and (ii) that the current regulatory framework allows financial institutions to offer responsible small-dollar loans.

The regulators emphasized the importance of launching new products or enhancing existing products with effective risk management practices, prudent lending policies and generally in a safe and sound manner. Regulators expect loan policies and practices to address the following:

- Loan structures, including credit amounts and repayment terms, that promote fair treatment, credit access, affordability and repayment in a reasonable time and that limit the instances of rollovers and re-borrowing;
- Loan pricing that complies with applicable law and reflects returns "reasonably related to the financial institution's product risks and costs";
- Loan underwriting that may use internal or external data to assess a customer's creditworthiness and to manage credit risk. Supervised institutions may use effectively managed new processes, technology and automation to lower the cost of providing small-dollar loans;
- Loan marketing and disclosures that comply with applicable laws and provide information in a clear, conspicuous, accurate and customer-friendly manner; and
- Loan servicing and safeguards that help customers achieve repayment and avoid a cycle of debt. According to the regulators, reasonable workout strategies and product restructuring (*e.g.*, into installment loan structures) may be considered for customers experiencing distress or unexpected circumstances.

Products offered through "effectively managed third-party relationships" should reflect similar pricing concerns. The pricing standard alone merits attention and fulsome discussion.

The guidance sets forth broad principles instead of prescriptive rules, which gives financial institutions some flexibility in offering small-dollar products to consumers or small businesses. The federal regulators intend for their interagency guidance to cover a variety of small-dollar loan structures from revolving credit to short-term loans to single-payment loans to long-term installment loans, except that the guidance does not apply to credit cards or overdraft programs.

<u>FDIC Action</u>

On May 20th, the FDIC also announced that it rescinded (i) its 2007 guidance (FIL-50-2007), which encouraged financial institutions to offer affordable small-dollar loans with reasonable interest rates (*e.g.*, 36% APR limits) and no or low fees and (ii) its 2013 supervisory guidance (PR-105-2013) on the risks of offering deposit advance products — a type of small-dollar, short-term credit product which is repaid by a deposit account customer's next direct deposit. The new interagency guidance replaces the rescinded restrictive small-dollar credit FDIC guidance.

<u>OCC Action</u>

The OCC also rescinded its Bulletin 2018-14, "Installment Lending: Core Lending Principles for Short-Term, small-Dollar Installment Lending," issued on May 23, 2018.

<u>CFPB Action</u>

Finally, on May 22nd, the Consumer Financial Protection Bureau ("CFPB") announced a new template that supervised depository institutions may use to apply for "no action" letters from the CFPB for installment loans and lines of credit up to $2,500 that incorporate certain standardized "guardrail" terms such as no balloon payments. The "no action" letter template is non-operative and non-binding meaning that the CFPB is not obligated to grant a "no action" letter. A resulting "no action" letter will include a statement that unless or until the letter is terminated, the CFPB will not make supervisory findings or bring a supervisory or enforcement action against the depository institution under the CFPB's authority to prevent unfair, deceptive or abusive acts or practices based on the depository institution offering or providing the small-dollar credit product described in the "no action" letter template. We have commented previously on the pros and cons of CFPB "no action"

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letters and state sandboxes. *See, e.g.,* our ALERT of March 7, 2016.

Since the COVID-19 pandemic hit the United States, the federal prudential regulators and the CFPB have encouraged supervised institutions to offer small-dollar loans to consumers and small businesses. Our firm regularly advises clients on innovative strategic planning and creative product development. We can help you launch new products or adjust existing products or practices to meet customers' new financial situations. ❑

✧ *Mike Tomkies and Susan Seaman*