

# PUBLICATION

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## Regulators Issue Small Dollar Lending Principles

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Earlier in March, the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA) and Office of the Comptroller of the Currency (OCC and collectively with the FRB, FDIC and NCUA, the "Regulators") issued a joint statement encouraging supervised institutions to offer small dollar loans to both consumers and small businesses in response to COVID-19. The Regulators offered little specific guidance on implementing and administering a small dollar lending program (SDLP) in a cost-effective manner while maintaining compliance with applicable law.

Many financial institutions expressed concerns that issues related to interest, underwriting, repayment terms and compliance needed to be addressed before they could invest the capital required to implement SDLPs.

As a result, on May 20, 2020, the Regulators offered additional guidance on SDLPs. The basic characteristics of an SDLP should reflect:

- A high percentage of repayment in accordance with loan terms;
- Repayment terms, pricing and safeguards that minimize adverse customer outcomes; and
- Repayment outcomes and program structure that enhance customer financial capabilities.

While the Regulators' guidance did not provide specifics on interest rates, underwriting and repayment terms, it did offer overarching principles to help financial institutions develop an SDLP that meets regulatory expectations.

### Specific Guidance

An SDLP may enhance a borrower's credit profile and possibly transition into additional financial products. The regulatory expectation is that SDLPs will be consistent with the financial institution's business plan and strategy as well as sound risk management policies. Such a program may include open-end lines of credit or closed-end loans with a balloon payment or installment payments.

SDLPs may be implemented in-house or through third-party relationships (properly managed in accordance with existing guidance). Innovative technology or processes (including alternative underwriting information) may be utilized for customers who may not meet a financial institution's traditional underwriting standards.

The Regulators' core lending principles for SDLPs include:

- Products that are consistent with safe and sound banking practices, treat customers fairly and comply with applicable law;
- Effective risk management (credit, operational and compliance); and
- Underwriting based on prudent policies and practices addressing the loan amounts, frequency of borrowing and repayment terms.

Loan policies and sound risk management practices and controls for SDLPs should address the following:

- Loan structures. Fair and reasonable loan amounts and terms that align with underwriting criteria and likely repayment ability. Moreover, such structures should not support a cycle of reborrowing, loan rollovers or immediate collectability in the event of default.
- Loan pricing. Returns based on the financial institution's risk and costs in compliance with applicable law.
- Loan underwriting. Analysis utilizing internal and/or external sources (such as deposit account activity) to assess creditworthiness. New processes, technologies and automation may be implemented to lower the cost of SDLPs.
- Loan marketing and disclosures. Marketing materials and disclosures that comply with consumer protection laws and are clear, accurate and "customer-friendly".
- Loan servicing and safeguards. Processes to assist customers in successful repayment including workout strategies and payment restructure when required.

As a result, financial institutions can apply their existing risk management criteria to develop SDLPs in accordance with their business plan. Products offered under a resulting SDLP must comply with applicable law but may utilize alternative underwriting data and analytical methods. However, the Regulators continue to expect that the SDLP will be offered in a safe and sound manner and that existing disclosure requirements will be met. Legal and regulatory requirements and guidance regarding Reg Z, Truth in Lending, ECOA, UDAAP, alternative underwriting, and vendor management still apply. Financial institutions should consult counsel to make sure any SDLPs being considered meet legal and regulatory obligations.

Further, institutions are encouraged to discuss plans for SDLPs with their regulator before implementation, especially if the SDLP constitute a substantial deviation from existing business plans.