OCC Gives Banks the Green Light to Make More Short-Term, Small-Dollar Loans

Overview: Earlier this summer, the Office of the Comptroller of the Currency (OCC) published a bulletin (OCC Bulletin) encouraging banks to re-enter the short-term, small-dollar lending market in order to help consumers meet their short-term financial needs without having to turn to alternative lenders. Additionally, Comptroller of the Currency Joseph Otting testified before the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs regarding the condition of the country’s banking system and his priorities as Comptroller, highlighting and reiterating the principles set forth in the OCC Bulletin; namely, that the OCC is focused on helping banks meet the credit needs of their customers and communities by scaling back what the Trump administration views as overly-cumbersome and ineffective financial regulations. Comptroller Otting also announced during his testimony the OCC’s plan to modernize the Community Reinvestment Act (CRA) in an effort to advance this initiative. This report summarizes the OCC’s recent informal guidance on short-term, small-dollar lending and what lenders can expect next in this arena.

Earlier this year, the Acting Director of the Bureau of Consumer Financial Protection (BCFP), Mick Mulvaney, indefinitely suspended the Obama-era payday lending rule that restricted certain types of short-term, small-dollar lending (i.e. payday loans and installment loans), including loans with maturities shorter than forty-five (45) days or longer-term loans that involve balloon payments. According to the OCC Bulletin, U.S. consumers currently borrow nearly $90 billion each year through these types of financial products, typically in amounts between $300 and $5,000; however, many banks have withdrawn from this market, forcing consumers to turn to alternative lenders that often charge significant fees and interest rates, trapping consumers into cycles of debt. In his testimony, Comptroller Otting reiterated his belief that banks can serve a significant portion of this market by offering safer, fairer, and less expensive alternative credit products to consumers.

In order to encourage banks to do just that, the OCC, in cooperation with the BCFP and other stakeholders, is working to clarify its position on short-term, small-dollar lending practices by rescinding potentially conflicting and “unduly burdensome” guidance (such as guidance regarding banks’ practices for offering deposit advance products) and outlining what it views as reasonable principles, policies, and practices for offering such installment loans. The OCC Bulletin noted that it was working with the BCFP to “ensure that OCC-supervised banks can responsibly engage in consumer lending, including lending products covered by the [payday lending rule].” However, in the meantime, the OCC encourages banks to continue offering short-term, small-dollar loans that are not covered by the payday lending rule, such as installment loans with maturities greater than forty-five (45) days that do not include balloon payments, using the following three (3) core lending principles for such products:
• Like other bank products, short-term, small-dollar loans should conform to safe and sound banking practices, comply with applicable laws and regulations, and treat consumers fairly;
• Banks should effectively manage the credit, operational, compliance, and reputational risks associated with these products; and
• Underwriting of credit products should be based on “reasonable policies and practices,” which includes implementing guidelines governing the amounts and frequency of borrowing and repayment requirements.

Additionally, the OCC Bulletin and Otting testimony identified the following policies and practices as reasonable for short-term, small-dollar lending:

• Banks should ensure that loan terms (including loan amounts) align with eligibility and underwriting criteria that promotes equitable access and treatment for all consumers;
  
  This includes: (i) structuring loans in such a way that borrowers can afford and successfully repay principal and interest within a reasonable amount of time; and (ii) analyzing alternative data sources (such as deposit activity) to assess a consumer’s creditworthiness in order to serve those who may not meet traditional credit standards but have the ability to repay.

• Loan pricing, especially as it relates to the rate of interest charged, should comply with applicable state laws and reflect best practices (i.e., the returns should reasonably relate to the risk and cost of a particular financial product and banks should avoid partnering with entities that might be attempting to evade state licensing and usury requirements);

• Marketing and disclosure information should be “transparent, accurate, and customer-friendly” and comply with applicable consumer protection laws and regulations;

• Loan servicing should include processes that effectively assist customers, especially distressed borrowers (e.g., by using “timely and reasonable workout strategies”); and

• Banks should timely report borrowers’ repayment activities in order to help consumers build or rebuild credit history and scores and demonstrate positive credit behavior so that they can transition into other mainstream financial products.

Comptroller Otting revealed in his testimony that the OCC does not intend to issue formal guidance on short-term, small-dollar lending, so as not to be “too restrictive,” but instead hopes to signal the OCC’s support of banks making these types of loans and provide banks with the “latitude” necessary to comfortably do so.

The OCC’s efforts in this area may get a significant boost by another priority Comptroller Otting announced during his testimony: the OCC, in connection with the other federal banking agencies, are preparing an advanced notice of proposed rulemaking (ANPR) that would solicit stakeholder input regarding how best to “modernize” the Community Reinvestment Act (CRA)—a law that Comptroller Otting says has become “too complex, outdated, cumbersome, and subjective” over the past four decades. Comptroller Otting hopes to: (1) expand the types of banking activities that qualify for CRA consideration (from predominately residential lending to include more small business, student, and responsible short-term, small-dollar consumer loans); (2) redefine assessment areas to encompass areas where institutions actually provide their services instead of narrow geographic boundaries; and (3) establish clearer, objective, and more transparent metrics and thresholds for determining a bank’s overall CRA performance and rating.
Outlook: The OCC Bulletin and Comptroller Otting’s testimony make clear that the OCC is giving banks the green light, and necessary regulatory certainty, to re-enter the short-term, small-dollar lending market—a move that Comptroller Otting and proponents, including many banking industry stakeholders, believe will benefit consumers by increasing the supply of safe and competitive loan options and providing a path for consumers to build credit and gain access to more traditional credit products. However, critics of the OCC’s announcements have expressed concerns that the move will simply spread the availability of predatory loan products and practices, citing previous instances of banks charging up to triple-digit interest rates on these types of credit products. Critics have also expressed concerns that changes to the CRA may weaken banks’ obligations to their communities instead of increasing the ways banks can invest in these communities, as proponents have suggested would be the case.

In addition to watching for additional informal guidance from the OCC in this arena in the coming weeks, interested parties should watch for publication of the ANPR and may wish to take advantage of the opportunity to provide comments.