

Summary

On March 26, 2020, five federal agencies (the OCC, FDIC, Federal Reserve, CFPB, and National Credit Union Administration (NCUA)) issued brief [joint guidance](#) to “specifically encourage” financial institutions to offer “responsible small-dollar loans” to both consumers and small businesses during the COVID-19 crisis. The guidance stresses that loans must be “responsible” and “fair.” The guidance does contain troubling language that could be read to permit banks to make payday loans. Banks should not read it that way and should stay out of the business of payday lending. They should also charge reasonable prices on installment loans, at no more than 36% APR.

Overview of the Guidance

The guidance notes that “responsibly offered small-dollar loans” can help with “temporary cash-flow imbalances, unexpected expense, or income short-falls during periods of economic stress or disaster recoveries.”

It notes that the “current regulatory framework allows financial institutions to make responsible small-dollar loans. Such loans can be offered through a variety of loan structures that may include, for example, open-end lines of credit, closed-end installment loans, or appropriately structured single payment loans.”

It states that products should be offered “in a manner that is consistent with safe and sound practices, provides fair treatment of consumers, and complies with applicable statutes and regulations, including consumer protection laws.”

The guidance states that financial institutions may, but are not required to, consult with their regulator about products they may offer to customers affected by COVID-19.

Takeaways

The guidance states that loans should be “responsible” and “fair” and made in a “safe and sound manner.” These principles dictate that loans should be both affordable and reasonably priced.

→ *No payday loans*

Regulators have long recognized that payday loans -- typically collected in full from the borrower’s next deposit of income or benefits -- are not made based on the borrower’s ability to repay, as sound lending requires. Rather, they are based on the lender’s ability to collect -- first in line, before the borrower can pay for other expenses and obligations. Borrowers are highly unlikely to be able to meet their other obligations and pay their basic living expenses if, when borrowers deposit their paychecks, lenders claw back the full amount lent, plus finance charges, in a single balloon payment. As a result, they often become caught in a cycle of high-cost lending that leaves them worse off rather than better.

Banks may call these loans “deposit advances,” but they are payday loans, through and through. When a handful of banks were making these loans before 2013 guidance led most to leave this market, the typical borrower had 13 of these loans a year, spending well over 100 days of the year in high-cost debt averaging 225-300% APR. Certainly any single-payment loan program in which significant numbers of borrowers take out back-to-back loans is not responsible, fair, safe or sound.

We know of only one bank making payday loans currently -- Fifth Third Bank, at rates up to an effective APR of 150%. No bank should start making them now.

→ *Only reasonably priced installment loans*

“Responsible,” “fair,” and “safe and sound” lending also requires that loans be reasonably priced. High-cost installment loans pose many of the same dangers single-payment payday loans present. Research strongly suggests these loans do not substitute for other high-cost credit borrowers have, but rather pile on, driving already-overburdened borrowers deeper into unsustainable debt.

The federal interest rate in cap for members of the military is 36% APR. This is an appropriate limit for credit extended to all Americans. Most states also have interest rate limits on installment loans, with a median cap of about 36%.

Many banks and credit unions already offer small dollar loan products at reasonable prices. These products include credit cards; even subprime cards often carry rates not exceeding 36%.

U.S. Bank is currently offering its “Simple Loan” product of up to \$1,000, repayable over three months, at an APR of 35.65%. Other banks could serve customers well by introducing products priced similarly or lower with thoughtful underwriting.

An ability-to-repay determination that takes into account a borrower’s expenses or obligations is important to ensuring that borrowers can afford the debt while continuing to meet ongoing expenses and obligations. Depositories have ready access to their customers’ checking account activity, which permits them to assess expenses and obligations efficiently.

Banks are getting loans at 0% from the Federal Discount Window. They should treat customers fairly and keep interest rates reasonable. Banks that may plan to introduce an installment loan product at rates exceeding 36% during this crisis would serve their customers better by keeping that product on the shelf.