Banks Should Not Read Federal Regulators’ COVID-19 Small Dollar Loan Guidance as Permitting Payday Loans

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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. This guidance contains 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.

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 made based on a borrower’s ability to repay the loan, on its terms, without reborrowing. Regulators have long recognized that asset-based lending is a form of abusive lending; that’s true whether that asset is a borrower’s home or a future deposit of income or benefits. Instead, sound lending must be based on consideration of a borrower’s income and obligations/debts/expenses.

Borrowers are highly unlikely to be able to afford to repay balloon-payment single-payment loans without being forced to reborrow. 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 to their leaving this market, the average number of loans borrowers had per year was 19, and borrowers spent well over 200 days of the year in 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.