Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
National Credit Union Administration
Office of the Comptroller of the Currency

Interagency Lending Principles for Offering Responsible Small-Dollar Loans

May 2020

The Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency (collectively, "the agencies") are issuing these principles to encourage supervised banks, savings associations, and credit unions (collectively, "financial institutions"[1]) to offer responsible small-dollar loans to customers for both consumer and small business purposes. The agencies recognize the important role that responsibly offered small-dollar loans can play in helping customers meet their ongoing needs for credit due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national emergencies, or disaster recoveries. Well-designed small-dollar lending programs can result in successful repayment outcomes that facilitate a customer's ability to demonstrate positive credit behavior and transition into additional financial products. The agencies offer these principles due to the evolving conditions and products in the small-dollar loan markets over the last several years.

The current regulatory framework allows financial institutions to offer responsible small-dollar loans. The agencies recognize that financial institutions are well-suited to meet these credit needs and some already offer these products, consistent with safe and sound principles and subject to applicable laws and regulations.[2] These lending principles cover a variety of small-dollar loan structures that may include open-end lines of credit with applicable minimum payments or closed-end loans with appropriate shorter-term single payment or longer-term installment payment structures.[3]

Responsible small-dollar loan programs generally reflect the following characteristics:

- A high percentage of customers successfully repaying their small dollar loans in accordance with original loan terms, which is a key indicator of affordability, eligibility, and appropriate underwriting;

[1] These principles do not apply to financial institution affiliated non-bank lenders or other non-bank lenders. These principles could apply to U.S. branches and agencies of foreign banks.

[2] See, e.g., Interagency Guidelines Establishing Standards for Safety and Soundness at 12 CFR 208, Appendix D-1 (Federal Reserve); 12 CFR 364, Appendix A (FDIC); and 12 CFR 30, Appendix A (OCC). Credit unions are subject to safety and soundness requirements under the Federal Credit Union Act and the NCUA's regulations. See, e.g., 12 U.S.C. 1786(b), (e); 12 CFR 741.3.

[3] These principles do not address financial institution overdraft programs or credit cards.

- Repayment terms, pricing, and safeguards that minimize adverse customer outcomes, including cycles of debt due to rollovers or reborrowing; and
- Repayment outcomes and program structures that enhance a borrower's financial capabilities.

Financial institutions seeking to develop new programs or expand existing responsible small-dollar lending programs should do so in a manner consistent with sound risk management principles, inclusive of appropriate policies.[4] Well-managed programs will generally align with the financial institution's overall business plans and strategies. Programs could include effectively managed deployment of innovative technology or processes for customers who may not meet a financial institution's traditional underwriting standards.[5] Such programs can be implemented in-house or through effectively managed third-party relationships.[6] In all programs, responsible lending products are offered in a manner that ensures fair access to financial services, fair treatment of customers, and compliance with applicable laws and regulations, including fair lending and consumer protection laws.

The agencies encourage financial institutions to refer to the core lending principles below when implementing reasonable policies and risk management practices for responsible small-dollar lending activities. Financial institutions may, but are not required to, discuss plans for small-dollar loan products with their supervisors before implementation, particularly if the offerings constitute substantial deviations from their existing business plans.

Core Lending Principles

The agencies believe that financial institutions can offer small-dollar loans safely and responsibly. Some financial institutions already offer a variety of small-dollar loan products on

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[4] For Federal Reserve: SR letter 95-51, "Rating the Adequacy of Risk Management Processes and Internal Controls at State Member Banks and Bank Holding Companies," and SR 16-11, "Supervisory Guidance for Assessing Risk Management at Supervised Institutions with Total Consolidated Assets Less than $50 Billion." Note as of June 8, 2016: See SR letter 16-11 for supervisory guidance on assessing risk management practices at state member banks, bank holding companies, and savings and loan holding companies (including insurance and commercial savings and loan holding companies) with less than $50 billion in total consolidated assets, and foreign banking organizations with consolidated U.S. assets of less than $50 billion. SR letter 95-51 remains applicable to state member banks and bank holding companies with $50 billion or more in total assets until superseding guidance is issued for these institutions. For FDIC: FDIC's Risk Management Manual of Examination Policies, Section 3.2 (Loans). For NCUA: Federal credit unions offering PALs small-dollar loans under 12 CFR 701.21(c)(7)(iii) and (iv) must follow the specified regulatory framework for those loan programs. For OCC: OCC Bulletin 2017-43, "New, Modified, or Expanded Bank Products and Services: Risk Management Principles."

[5] Refer to Interagency Statement on the Use of Alternative Data in Credit Underwriting (December 3, 2019). FIL-82-2019 (December 13, 2019)

[6] For Federal Reserve: SR letter 13-19/CA 13-21, "Guidance on Managing Outsourcing Risk." For FDIC: Financial Institution Letter (FIL) 44-2008, "Third-Party Risk: Guidance for Managing Third-Party Risk" dated June 6, 2008. For NCUA: NCUA Letter to Credit Unions 07-CU-13, "Evaluating Third Party Relationships" (December 2007) and NCUA Supervisory Letter 07-01, "Evaluating Third Party Relationships" (October 2007). For OCC: OCC Bulletin 2013-29, "Third-Party Relationships; Risk Management Guidance," dated October 30, 2013. Also see OCC Bulletin 2020-10, "Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29," dated March 5, 2020.

an open-end line of credit or closed-end basis with various minimum payments, installment payments, and maturities.

The agencies' core lending principles for financial institutions that offer small-dollar loan products include:

- Loan products are consistent with safe and sound banking, treat customers fairly, and comply with applicable laws and regulations.
- Financial institutions effectively manage the risks associated with the products they offer, including credit, operational, and compliance.
- Loan products are underwritten based on prudent policies and practices governing the amounts borrowed, frequency of borrowing, and repayment requirements.

Prudent lending policies and sound risk management practices together support a financial institution's ability to identify, monitor, manage, and control the risks inherent in its lending activities, including responsible small-dollar lending programs. As noted above, there are several associated risks to be managed in the offering of loan products. Effective management of such risks may include new product development protocols that address, among other issues, the clear disclosures of terms, the risk profile of customers using the products, the use of new technologies, the use of alternative underwriting information, or the use of third-party arrangements.

Reasonable loan policies and sound risk management practices and controls for responsible small-dollar lending would generally address the following:

- **Loan structures**: Loan amounts and repayment terms that align with eligibility and underwriting criteria and that promote fair treatment and credit access of applicants, and product structures, including shorter-term single payment structures, that support borrower affordability and successful repayment of principal and interest/fees in a reasonable time frame rather than reborrowing, rollovers, or immediate collectability in the event of default.

- **Loan pricing:** Loan pricing that complies with applicable state and federal laws and reflects overall returns reasonably related to the financial institution's product risks and costs. Any products offered through effectively managed third-party relationships would also reflect the core lending principles, including returns reasonably related to the financial institution's risks and costs.

- **Loan underwriting**: Analysis that uses internal and/or external data sources, such as deposit account activity, to assess a customer's creditworthiness and to effectively manage credit risk.[7] Such analysis may facilitate sound underwriting for credit offered to non-mainstream customers or customers temporarily impacted by natural disasters, national emergencies, or economic downturns. Underwriting can also use effectively

[7] *S*upra, note 5.

managed new processes, technologies, and automation to lower the cost of providing responsible small-dollar loans.

- **Loan marketing and disclosures:** Marketing and customer disclosures that comply with consumer protection laws and regulations and provide information in a clear, conspicuous, accurate, and customer-friendly manner. Applicable laws and regulations may include but are not limited to the Equal Credit Opportunity Act, the Truth in Lending Act, Section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive acts and practices, and Section 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which prohibits unfair, deceptive, or abusive acts and practices.

- **Loan servicing and safeguards:** Processes that assist customers in achieving successful repayment while avoiding continuous cycles of debt and significant credit costs due to rollover or reborrowing. For customers who experience distress or unexpected circumstances affecting their ability to repay small-dollar loans, such processes may include timely and reasonable workout strategies. Such processes could also include restructuring single payment loans or open-end lines of credit into installment loan structures in appropriate circumstances.