Not Enough Small-Dollar Lending by Banks? The GAO Points the Finger

Greg Baer | March 29, 2022

For years, banks have been reluctant to offer small-dollar loans to low- and moderate-income people. A recent report from the GAO explains why: fear that such lending will be punished, not rewarded. According to the GAO, that fear has arisen from vague, volatile and inconsistent guidance from multiple federal agencies acting individually or in concert and a resulting concern that even a lending program lauded by one regulator one year could be penalized by that regulator or another the next.

The GAO details past efforts by the agencies and the CFPB to discourage such lending. Of equal importance, the GAO explains that even when one of those agencies decided to *encourage* some form of small-dollar lending, such action had little effect. Banks recognize, based on experience well documented in the report, that any favorable guidance could be rescinded, or that another agency might take a different, even contradictory view. The GAO further explains what bankers know and regulators often ignore: product development requires years to go from concept to viability, and thus banks are reluctant to invest time and resources in a product that could subsequently become disfavored. Today's regulatory safe harbor could be next year's squally sea.

We reprint this section of the GAO report below in its entirety. It is a must-read for anyone who cares about expanding credit availability.

As a side note, what makes the situation especially disconcerting is that Congress in the 2010 Dodd-Frank Act created a new consumer regulatory regime at least in part to prevent such an outcome. Specifically, Congress created the CFPB and endowed it with sole authority to administer the nation's core federal consumer financial protection laws.[1] All regulatory, interpretive, examination and enforcement authority for those laws was explicitly transferred from the banking agencies to the CFPB for all banks with assets greater than $10 billion. Nonetheless, the banking agencies continue to regulate, interpret, examine and enforce the transferred consumer laws as if the legislation had not been enacted, seemingly nullifying Congress' mandate.

Not surprisingly, then, post-2010, banks have been forced to the sidelines in this market, while payday lenders, pawn shops and other providers of high-cost credit have continued their business without meaningful interruption. The CFPB's 2017 Payday Lending Rule imposed some restrictions on the payday loan industry, and the CFPB also has taken occasional enforcement actions against those lenders. But payday lenders and other non-banks do not

[1] 12 U.S.C. § 5581 *et seq*. ("All consumer financial protection functions of the Comptroller of the Currency are transferred to the Bureau.") (parallel language for other banking agencies). The Dodd-Frank Act further granted the Bureau "exclusive authority to require reports and conduct examinations" over the consumer protection laws for insured depository institutions with over $10 billion in assets. 12 U.S.C. § 5515. The federal banking agencies retained that authority only for banks with $10 billion or less in total assets. 12 U.S.C. § 5516.

face constant supervision and *de facto* product approval requirements imposed on banks; they do not worry that they will see their examination ratings downgraded and their growth curtailed. They survive and advance.

To be sure, a few larger banks have commendably launched small-dollar lending programs, but the terms of those programs are narrowly defined and were the product of extensive and lengthy pre-negotiation with the relevant agencies; at BPI, we spent over a year negotiating a safe harbor for one type of small-dollar loan. This is not a scalable model: there is no room for innovation, and most banks do not have the resources to run a complex and lengthy regulatory and political gauntlet to get a program approved.

There is a clear way out of this modern-day Babel and its sad consequences for low- and moderate-income Americans looking for short-term, small-dollar loans. Congress should conduct oversight hearings and insist that the CFPB prohibit by notice-and-comment regulation any small-dollar lending practices it determines to be unfair or abusive but otherwise allow banks to innovate and expand their small-dollar offerings. The banking agencies should accept the CFPB's consumer protection role and acknowledge that small-dollar loans to low- and moderate-income people do not present any material risk to a diversified bank and therefore are not a safety and soundness concern. (If there is any doubt, they should establish by regulation a safe harbor for programs that put only an immaterial percentage of the bank's capital at risk.)

These steps would unlock credit for tens of millions of deserving Americans. Banks would be no less safe, and the only losers would be the companies offering high-cost credit in the shadows of regulation.

Here follows the relevant section of the GAO report. The full report, which also looks at regulatory impediments to other banking products, is accessible here: https://www.gao.gov/products/gao-22-104468.

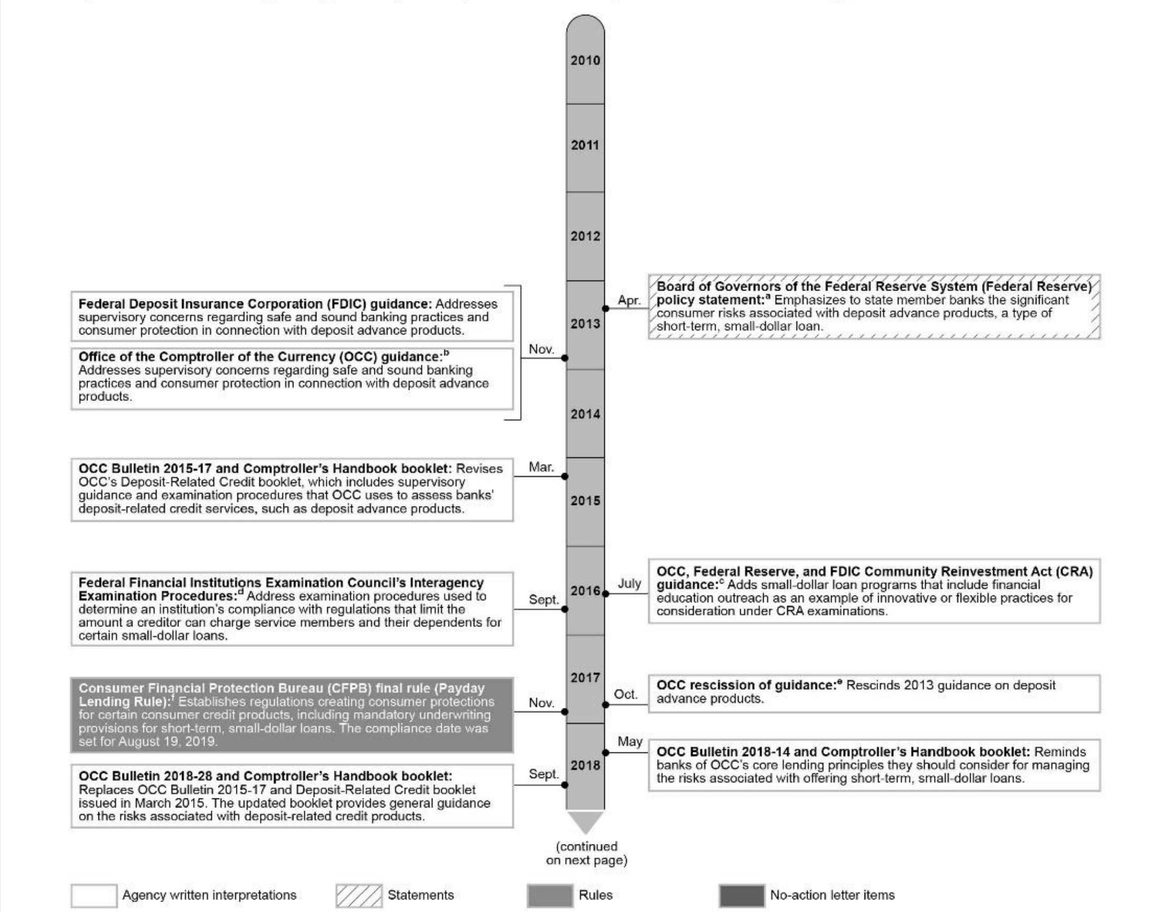
Market Participants and Observers Indicated That Regulatory Uncertainty Around Small-Dollar Lending Affected Availability

[Excerpt from a U.S. Government Accountability Office Report, February 2022]

Most of the market participants and observers who commented on regulatory uncertainty around small-dollar loans told us banks are hesitant to offer such loans in part because of changes to related rules or guidance in recent years.[1] In particular, some market participants and observers noted that banks do not want to offer small-dollar products because they are expensive to develop and the regulations or supervisory expectations may change.

From 2010 through 2020, CFPB, the Federal Reserve, FDIC, and OCC issued or rescinded at least 19 actions related to small-dollar loans (see fig. 8). These actions included issuing rulemakings, statements, agency booklets, and principles.

Figure 8: Timeline of Regulatory and Supervisory Actions Involving Bank Small-Dollar Lending, 2010–2020



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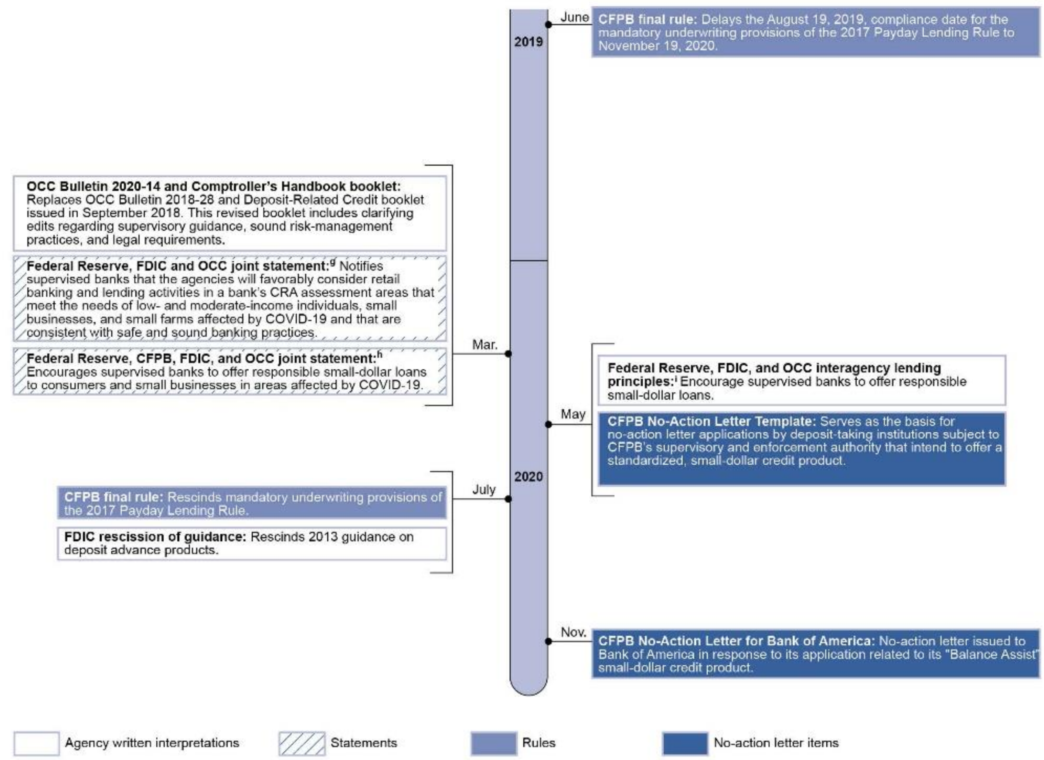
[1] Eighteen market participants and observers (nine banks, three consumer groups, five industry groups, and one research organization) commented on the effects of regulatory actions on small-dollar lending.



Source: GAO analysis of Federal Reserve, FDIC, OCC and CFPB regulatory actions. | GAO-22-104488

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[a]The Federal Reserve used CA13-7 to transmit this statement.

[b]OCC used OCC Bulletin 2013-40 to announce the issuance of the agency's final supervisory guidance.

[c]This guidance was not exclusively related to small-dollar loans.

[d]The Federal Reserve, CFPB, FDIC, and OCC issued examination procedures tailored for use by each agency. We excluded the agency-specific procedures from the timeline. These examination procedures were not exclusively related to small-dollar loans.

[e]OCC also rescinded OCC Bulletin 2013-40.

[f]A legal challenge to the rule was filed on April 9, 2018, and is pending appeal in the United States Court of Appeals for the Fifth Circuit. In October 2021, the Fifth Circuit extended the compliance date of the rule until 286 days after resolution of the appeal.

For example, the banking regulators have issued and rescinded supervisory information related to deposit advance products.[2] In 2013, the Federal Reserve issued a statement highlighting potential consumer harm and elevated compliance risk associated with these products.[3] That same year, OCC and FDIC issued supervisory guidance that also described the products' potential to harm consumers and elevated compliance risks.[4] The OCC and FDIC guidance encouraged banks offering deposit advance products to apply more scrutiny in underwriting these loans and to discourage repetitive borrowing. According to representatives of the Consumer Bankers Association, OCC and FDIC's 2013 guidance were restrictive, which made it difficult for banks to offer deposit advance products. Representatives from one bank told us the bank stopped offering advances on direct deposits in 2014, following OCC's new guidance.

Although OCC rescinded its 2013 guidance in 2017, the regulatory landscape for small-dollar lending products remained fluid. According to OCC, the agency rescinded this guidance in preparation for the implementation of a new CFPB rule on small-dollar loans. FDIC also rescinded its guidance in 2020, stating it was in response to the issuance that same year of the interagency lending principles for offering responsible small-dollar loans. The Federal Reserve told us its

[2] Deposit advance products are a type of short-term, small-dollar loan offered to certain account holders who have recurring electronic deposits to their accounts—such as direct deposit of their paycheck.

[3] Board of Governors of the Federal Reserve System, *Statement on Deposit Advance Products,* CA 13-7 (Washington, D.C.: Apr. 25, 2013).

[4] Federal Deposit Insurance Corporation, *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products* (Washington, D.C.: Nov. 26, 2013); and Office of the Comptroller of the Currency, *Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products* (Washington, D.C.: Nov. 26, 2013).

statement on deposit advance products was at a higher level than the other banking regulators' guidance (as it discussed applicable laws and regulations associated with offering these loans) and was in effect as of January 2022.

Furthermore, in November 2017, CFPB issued its final rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans (Payday Lending Rule), which included underwriting requirements for small-dollar loans.[5] In a July 2020 rule, CFPB revoked the underwriting provisions prior to the corresponding compliance date.[6] CFPB stated it amended the regulation based on its reevaluation of the legal and evidentiary bases for these provisions.[7]

Some market participants and observers told us they did not believe the Payday Lending Rule was sufficiently stable for banks to offer small-dollar loans. According to the Independent Community Bankers of America, when the rule was issued, some banks that offered small-dollar loans stopped doing so because of the mandatory underwriting requirements.

Although CFPB has since rescinded these requirements, four market participants and observers told us that banks believe CFPB again could change the rule. In March 2021, the CFPB Acting Director addressed small-dollar lending by mentioning that ability to repay is an important underwriting standard and that, if appropriate, the agency will consider the use of rulemaking to address the need for such a standard.[8] However, based on its most recent regulatory agenda (Fall 2021), CFPB did not include any regulations related to small-dollar lending.

More recently, the banking regulators and CFPB have taken several actions to encourage banks and credit unions to offer small-dollar loans. For example, in May 2020, OCC, FDIC, and the Federal Reserve issued interagency lending principles that encouraged banks to offer these loans.[9] In May 2020, CFPB also issued a no-action letter template for small-dollar credit products.[10] The agency noted that it approved the template to increase competition in the small-dollar lending market, foster access to credit, and include important protections for consumers. In November 2020, CFPB granted a no-action letter to Bank of America for certain small-dollar credit products based on the template.

Despite these actions by the regulators, some market participants and observers said regulatory uncertainty remains among banks. For instance, representatives for two banks expressed concern that the interagency principles would be subject to revision with a change in administration. Representatives from The Pew Charitable Trusts told us the Payday Lending Rule, CFPB's 2020 no-action letter template, and the 2020 interagency lending principles on small-dollar lending were helpful in establishing clear regulatory expectations for small-dollar lending products. But they also stated that CFPB's 2020 rescission of certain provisions of the Payday Lending Rule created the appearance of regulatory uncertainty that the 2017 rule previously addressed.

Lastly, some market participants and observers who commented on regulatory uncertainty, including four banks, had concerns that the current guidance did not provide clear guidelines for banks that would shield them from regulatory

[5] These provisions, referred to as the mandatory underwriting provisions, stated that it is an unfair and abusive practice for a lender to make a covered short-term or longer-term balloon payment loan, including payday and vehicle title loans, without reasonably determining that consumers have the ability to repay those loans according to their terms. The provisions prescribed mandatory underwriting requirements for making the ability-to repay determination; exempted certain loans from the mandatory underwriting requirement; and established related definitions, reporting, recordkeeping, and compliance date requirements. A legal challenge to the rule was filed on April 9, 2018. Community Financial Services Association of America, Ltd. and Consumer Service Alliance of Texas v. CFPB, 1:18-cv-295 (W.D. Texas). In August 2021, the district court issued a summary judgment in favor of CFPB permitting the regulation to stand. The plaintiff appealed to the United States Circuit Court of Appeals for the Fifth Circuit, Case No. 21-50826. In October 2021, the Fifth Circuit extended the compliance date of the rule until 286 days after resolution of the appeal.

[6] Under the July 2020 rule, CFPB revoked the mandatory underwriting provisions prior to the corresponding compliance date.

[7] In developing the 2019 Notice of Proposed Rulemaking, the agency stated it took into account the input it received from stakeholders through its efforts to monitor and support industry implementation of the 2017 final rule, as well as comments received in response to other agency initiatives.

[8] Dave Uejio, "Our commitment to protecting vulnerable borrowers"; blog post by the CFPB Acting Director (March 23, 2021). Accessed athttps://www.consumerfinance.gov/about-us/blog/our-commitment-to-protecting-vulnerableborrowers/.

[9] The joint statement listed three core lending principles: (1) loan products are consistent with safe and sound banking, treat customers fairly, and comply with applicable laws and regulations; (2) financial institutions effectively manage the risks associated with the products they offer, including credit, operational, and compliance; and (3) loan products are underwritten based on prudent policies and practices governing the amounts borrowed, frequency of borrowing, and repayment requirements. NCUA was also a part of this joint issuance

[10] According to CFPB, no-action letters are intended to provide increased regulatory certainty that CFPB will not bring a supervisory or enforcement action against a company for providing a product or service under certain facts and circumstances. The May 2020 template identified certain features that would serve as "guardrails" and be included in applications for no-action letters using the template.

risks. For example, representatives of one bank noted that the interagency principles were defined at a high level and did not provide any specificity on how a bank could provide these loans and be reasonably assured that it would be shielded from regulatory risks.