

### Small-Dollar Lending

#### Purpose

These procedures provide a framework for examiners when reviewing small-dollar loan programs. As with other products and services, it is not mandatory for examiners to review small-dollar loan programs at every financial institution. Whether or not to review a particular small-dollar loan program is determined as a part of the regular scoping process and based on the residual risk of the product and/or service at each institution.

#### Background

There is a broad range of small-dollar lending products in the marketplace. While there are various statutory and regulatory definitions related to small-dollar lending for specific purposes, the FDIC has not adopted a specific definition of small-dollar loans. The examination approaches discussed in these examination procedures are broadly applicable to a range of small-dollar lending products<sup>1</sup> and should be utilized on a risk-focused basis, consistent with the FDIC's overall approach to consumer compliance examinations, to address how examiners should review institutions that routinely originate small-dollar loans for their customers or as part of third-party relationships. Because these instructions are intended to be applied on a risk-focused basis, it is not anticipated that these will typically be utilized for situations in which an institution makes small-dollar loans infrequently as accommodations for existing customers on an ad hoc basis (as opposed to broadly offering a small-dollar lending product or program).

Well-designed small-dollar loan products that exhibit the characteristics described in the [Interagency Lending Principles for Offering Responsible Small-Dollar Loans \(FIL-58-2020\)](#) can provide significant value to customers. Responsibly offered small-dollar loans can play an important role 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

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<sup>1</sup> There are a variety of types of small-dollar loan programs and product structures, which include open-end lines of credit with applicable minimum payments or closed-end loans with shorter-term or longer-term balloon or installment payment structures. For example, both balloon payment loans of several hundred dollars with repayment terms over a number of weeks and longer-term installment loans of thousands of dollars repayable over months, or even years, are often considered to be small-dollar loans. Although aspects of these procedures may be appropriate for various other forms of lending, these examination procedures are not specifically intended to address overdraft programs, credit cards, real estate secured credit, or auto loans.

successful repayment outcomes that facilitate a customer's ability to demonstrate positive credit behavior and transition into additional financial products.

However, consumer compliance examiners should also be aware of the compliance risks associated with small-dollar loan products. Certain small-dollar loan products may have elevated risk of consumer harm, particularly when they do not exhibit the characteristics described in the [Interagency Lending Principles for Offering Responsible Small-Dollar Loans \(FIL-58-2020\)](#). For example, as with other types of lending products, performance analysis by the FDIC or by the institution finding high charge-off or default rates, or high rates of refinancing or reborrowing associated with a particular loan program, may suggest an elevated risk of consumer harm. Examiners should assess the inherent risks, including those associated with loan product characteristics, such as repayment terms, pricing, and lack of safeguards, that may lead to cycles of debt due to rollovers or reborrowing. As with other products, examiners should also consider the extent to which compliance management system elements, such as policies and procedures, effectively mitigate the risk of consumer harm and violations of applicable laws and regulations. Loan programs that are offered without adequate compliance management practices and controls may present elevated consumer compliance risk and risk of potential consumer harm.

#### Applicable Laws and Regulations and Other Supervisory Resources

Examiners should continue to reference appropriate chapters in the FDIC Consumer Compliance Examination Manual governing laws and regulations that may be applicable to small-dollar loan programs. Potentially applicable statutes and regulations that may apply to small-dollar programs include the following:

- Prohibitions Against Unfair, Deceptive, or Abusive Acts or Practices under Section 5 of the Federal Trade Commission Act (FTC UDAPs) and Section 1036(a)(1)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. § 5536(a)(1)(B)) (Dodd-Frank UDAAPs);
- The Truth in Lending Act (TILA) and Regulation Z;
- The Military Lending Act (MLA) and its implementing regulations;
- The Servicemembers Civil Relief Act (SCRA);
- The Electronic Fund Transfer Act (EFTA) and Regulation E;
- The Fair Debt Collection Practices Act (FDCPA) and Regulation F;

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- The Fair Credit Reporting Act (FCRA) and Regulation V;
- The Gramm-Leach-Bliley Act (GLBA) and Regulation P;
- The Equal Credit Opportunity Act (ECOA) and Regulation B; and
- The Community Reinvestment Act (CRA) and its implementing regulations.

Additional resources that may be relevant to certain small-dollar loan programs, depending on the facts and circumstances, include, for example, [Interagency Lending Principles for Offering Responsible Small-Dollar Loans \(FIL-58-2020\)](#), [FDIC's Supervisory Policy on Predatory Lending \(FIL-6-2007\)](#), and [Interagency Expanded Guidance for Subprime Lending Programs \(FIL-9-2001\)](#). Additional information about these resources, as well as some potentially relevant aspects of these laws and regulations, is included in an Appendix to these examination instructions.

### Third-Party Arrangements

Financial institutions may have small-dollar loan programs that they administer directly or may enter into arrangements with third parties. In the latter situation, the institution often enters into an agreement in which the third party primarily interacts with the customer. Third-party arrangements, when not properly managed, can increase institutions' risks, including, for example, transaction, compliance, operational, and legal risks.<sup>2</sup> The use of third parties does not diminish the responsibility of the board of directors and management to ensure that the activity performed on behalf of the institution is conducted in a safe and sound manner that complies with applicable laws and regulations, including those that protect consumers.

Third parties involved in small-dollar lending may also be subject to federal and state laws, including requirements regarding licensure and/or the pricing and terms of loans offered through the third party, notwithstanding whether the financial institution is designated as the lender in the transaction. If a third party offering loans as part of a business relationship with an FDIC-supervised institution is found by a court of competent jurisdiction or a federal or state regulatory authority to have engaged in practices that are not compliant with applicable federal or state laws, the

institution may face risks for facilitating or participating in the third party's unlawful activity.<sup>3</sup>

### Examination Instructions

During the examination process, examiners should perform the following, as appropriate.

- Determine if an institution or its affiliates originate, service, or engage in the collection of small-dollar loans or otherwise offer or participate in a small-dollar lending program and assess the level, complexity, and risk of potential consumer harm associated with the institution's small-dollar lending activities.
  - During the pre-examination planning (PEP) process, an examiner should ask during the PEP interview if an institution or its affiliates have a small-dollar lending program, including a program to offer small-dollar loans in conjunction with third parties. Examiners may also identify such activities when they gather and review various internal and external information to understand an institution's structure, supervisory history, and operations. Such information may include, for example, prior compliance and risk management reports of examination,<sup>4</sup> prior audit and monitoring reports, prior examination workpapers, financial data, correspondence, and complaint information.
  - In assessing the risk of potential consumer harm, consider data on the total number of loans made in the program, the number of third-party arrangements related to small-dollar loans, complaint data related to the program, including complaint data related to third parties, as applicable, and any investigations or enforcement actions related to the small-dollar lending program. When reviewing complaint data for institutions with loans offered in connection with consumer-facing third parties, searches of databases or for online complaints should also be based on product and/or third party names.
- Assess whether the institution has developed and implemented a Compliance Management System (CMS)

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<sup>3</sup> Under Section 3(v) of the FDI Act, a bank may be found to have violated a law or regulation if it caused, brought about, participated in, or otherwise aided or abetted a third party in violating such a law or regulation.

<sup>4</sup> As noted in the RMS Manual of Examination Policies (3.2-84), with respect to payday lending programs administered directly by the bank or as part of a third-party arrangement, concurrent risk management and consumer protection examinations should be conducted absent overriding resource or scheduling problems. In all cases, a review of each discipline's examinations and workpapers should be part of the examination planning process. Relevant state examinations also should be reviewed.

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<sup>2</sup> See [Guidance for Managing Third-Party Risk \(FIL-44-2008\)](#) for additional information about potential risks arising from third-party relationships and information about identifying and managing such risks.

that is robust enough to ensure that small-dollar lending programs, whether offered directly or in connection with a third-party arrangement, comply with applicable consumer protection laws and regulations. For example, the institution's CMS should demonstrate that:

- Board and management understand the consumer compliance responsibilities and consumer harm risks associated with the institution's activities and allocate resources commensurate with their level and complexity;
  - Consumer protection laws and regulations are considered and incorporated into policies, procedures, and training, as appropriate;
  - Activities are periodically monitored or audited, commensurate with the level and complexity of the institution's business and the associated risk, to ensure responsibilities are carried out and requirements are met;
  - Corrective action is taken, as necessary, to address violations of law or regulations or consumer harm; and
  - Consumer complaints related to the small-dollar lending program are handled properly and promptly.
- Review the institution's, and, if applicable, the third party's, formal or informal policies, procedures, and guidelines regarding:
    - Criteria used to underwrite each small-dollar loan product, including the assessment of the borrower's ability to repay;
    - Expected rates of default or refinancing;
    - Renewals or extensions, and policy exceptions;
    - Loan pricing and fee assessment (i.e. late payment, returned payments);
    - Working with borrowers who experience distress or unexpected challenges making timely payments; and
    - Borrower repayment options and whether the institution has a default repayment method (e.g. if automatic payments are the default payment method), extended payment plans, and refinancing.
  - Review all marketing materials and disclosures related to small-dollar loans to ensure programs' features, terms, and conditions are accurately disclosed in a clear and conspicuous manner. If the institution is offering a small-dollar loan program involving a third party, evaluate whether the institution effectively monitors the third party's marketing materials and disclosures to ensure they comply with applicable regulations and are not marketed in a way that is deceptive or discriminatory.
  - Review any management or board reports on the small-dollar loan program, including any exceptions, past due, collections, and complaint reports.
  - When reviewing an institution's small-dollar loan program, either offered directly or in connection with a third-party arrangement, examiners should consider the risk of consumer harm and perform transaction testing for compliance with applicable consumer protection laws and regulations, as warranted.
    - To determine if transaction testing is warranted, examiners should assess the CMS as it pertains to the institution's small-dollar loan program. The absence of or insufficient written policies and procedures, training, monitoring and/or audit procedures or the presence of consumer complaints may indicate the need for transaction testing.
    - In addition, the program's overall default rates or charge-off rates, and the average number of accounts or loans per customer (or the average number of "refinances" per customer) may be important indicators of whether transaction testing is warranted and the extent of such transaction testing. Such data may be particularly relevant in assessing certain marketing claims, for example claims regarding "building credit" or "working with customers to help them meet their financial goals."
    - Transaction testing of small-dollar loans programs should generally determine, among other things, whether lending practices exist that may appear to be unfair, deceptive, or abusive.
  - Assess whether the risk of FTC UDAP or Dodd-Frank UDAAP is elevated. Following are examples of considerations when determining if the risk of FTC UDAP or Dodd-Frank UDAAP is elevated with a small-dollar loan program (*not an exhaustive list*):
    - Consumer complaints suggest practices related to marketing, origination, servicing, or debt collection may be unfair, deceptive, or abusive;
    - Marketing materials or disclosures are not clear, complete, and accurate;
    - Marketing materials appear to overstate or misrepresent purported benefits, features, or discounts;
    - The institution operates the small-dollar loan program with limited and ineffective risk management, reporting, or internal controls;

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- The small-dollar loan program lacks controls or limits on the number and frequency of extensions, deferrals, renewals, and rewrites that a customer may receive;
  - Transaction testing demonstrates that borrowers rollover, renew, or obtain similar loans from the institution in a manner inconsistent with relevant limits established by the institution;
  - Loan amounts and repayment terms do not align with eligibility and underwriting criteria;
  - Loan terms include product structures, loan amounts, or repayment terms that require payments that are likely to be unaffordable for borrowers;
  - The small-dollar loan program does not promote successful repayment of principal, interest, and fees in a reasonable timeframe without the need to re-borrow, as indicated by high rates of charge-off or default, refinancing, or re-borrowing;
  - The institution provides additional advances to finance unpaid interest and fees;
  - The institution originates simultaneous loans to the same customer;
  - Transaction testing reveals material omissions or misrepresentations that conceal or discourage use of lower cost repayment or workout options; or
  - The institution does not effectively oversee the practices of one or more third parties involved in a small-dollar lending program related to marketing, underwriting, servicing, collection, or other aspects of the program.
- Examiners should consider any potential unfair, deceptive, or abusive acts or practices that may be apparent with any loan product, including small-dollar loans made as a part of a small-dollar loan program.
  - Examiners should also consider any factors that may mitigate FTC UDAP and Dodd-Frank UDAAP risks, depending on the facts and circumstances. This may include, for example, loan servicing and safeguards, collection practices, and processes that assist customers in achieving successful repayment while avoiding continuous cycles of debt (e.g. cooling off periods). For customers who experience distress or unexpected circumstances affecting their ability to repay small-dollar loans, mitigating factors for institutions 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.
- If examiners identify potential violations of FTC UDAP or Dodd-Frank UDAAP, they should follow applicable regional and Washington Office consultation procedures.
  - If the institution is offering a small-dollar loan program in connection with a third party, evaluate whether the institution is effectively monitoring the third party's compliance with applicable federal and state laws and regulations related to the institution's program. If the third party has been found to violate federal or state laws by a court of competent jurisdiction or federal or state regulatory authority, or if the third party is involved in active litigation with a federal or state regulatory authority related to potential violations of federal or state laws, including lending or licensure laws, in connection with the offering of the small-dollar loans that involve a relationship with the institution, a Washington Office consultation should be initiated.
  - Small-dollar loan programs may be considered when reviewing consumer loans for compliance with ECOA under the Interagency Fair Lending Examination Procedures. If the institution, on its own or through a third-party relationship, underwrites and/or prices small-dollar loans using automated systems, such reviews should consider the steps the institution takes to monitor, evaluate, and mitigate the fair lending risks associated with these systems.
  - If an institution has a small-dollar loan program that is responsive to the needs of those with low and moderate incomes and requests CRA credit, examiners should evaluate the program according to current CRA guidelines. However, if the institution has violated FTC UDAP, Dodd-Frank UDAAP, or ECOA, or is cited for other illegal credit practices related to its small-dollar loan program, examiners should consider whether a possible downgrade in the CRA rating is warranted, based on the specific facts and circumstances, because such an adverse finding would be inconsistent with helping to meet community credit needs.

### Supervisory Approach

Examiners should use examination guidance and instructions, including applicable regional and Washington Office consultation procedures, to review and evaluate small-dollar loan programs in a risk-based manner. Institutions infrequently offering small-dollar loans as accommodations for existing customers on an ad hoc basis will generally not be reviewed. In addition, institutions offering small-dollar loan programs consistent with Interagency Guidelines for

Responsible Small-Dollar Loans will generally not be subject to examination criticism, if appropriately managed.

Examiners should discuss with field management any significant deficiencies in an institution's CMS for small-dollar lending activities identified that pose elevated risk for consumer harm. Examiners and their immediate supervisor should also discuss any potential safety and soundness concerns, such as high default rates or failure to adequately consider a borrower's ability to repay, with risk management counterparts.

### **Appendix: Additional Resources**

*The following summarizes various existing resources, including FDIC and interagency guidance, as well as laws and regulations, that may be relevant to small-dollar lending programs, depending on the specific facts and circumstances of a program and the scope, coverage, or focus of the particular law, regulation, or other resource.*

#### **Laws and Regulations**

The FDIC's risk-scoping examination approach requires consumer compliance examiners to focus their attention on operational areas that present the greatest potential risk of consumer harm, as appropriate, including consideration of small-dollar loan programs. As part of this process, examiners should continue to consider those laws and regulations that are generally applicable to small-dollar loan programs, including those described below.

#### ***Prohibitions Against Unfair, Deceptive, or Abusive Acts or Practices***

Section 5 of the Federal Trade Commission (FTC) Act prohibits unfair or deceptive acts or practices (FTC UDAPs). Section 1036(a)(1)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. § 5536(a)(1)(B)) prohibits any covered person or service provider from engaging in, among other things, abusive acts or practices in connection with a consumer financial product or service (Dodd-Frank UDAAPs). Potential FTC UDAP and Dodd-Frank UDAAP risk factors are discussed under examination instructions. An FTC UDAP and/or Dodd-Frank UDAAP finding is dependent on the relevant facts and circumstances.

#### ***Truth in Lending Act***

The Truth in Lending Act (TILA) and its implementing regulation, Regulation Z, require lenders to disclose the costs of credit, including loan terms and the annual percentage rate (APR). TILA also requires lenders to provide certain account disclosures at various points during the credit process, and

periodic statements after the consumer obtains the loan. Note that the regulatory requirements for open-end and closed-end loans differ.

#### ***Military Lending Act***

The Military Lending Act (MLA) instituted an annual interest rate limit of 36 percent for certain types of loans to active duty service members and their families. This limit is referred to as the Military Annual Percentage Rate (MAPR) and applies to all forms of payday loans, vehicle title loans, deposit advance loans, refund anticipation loans, installment loans, unsecured open-end lines of credit, and credit cards.

#### ***Servicemembers Civil Relief Act***

The Servicemembers Civil Relief Act (SCRA) provides additional protections for active-duty service members. For example, under the SCRA, creditors must, upon receiving a written notice and a copy of military orders, reduce the interest rate on any pre-service loans incurred by the servicemember, or a servicemember and spouse jointly, to no more than 6 percent per year for the duration of the servicemember's military active-duty service for most loans and for mortgages, and for an additional year after the end of active duty.

#### ***Electronic Fund Transfer Act***

The Electronic Fund Transfer Act (EFTA) and its implementing regulation, Regulation E, protect consumers engaging in an electronic fund transfer (EFT). Among other things, EFTA prohibits lenders from requiring, as a condition of loan approval, a customer's authorization for loan repayment through a recurring EFT, except in limited circumstances.

#### ***Fair Debt Collection Practices Act***

The Fair Debt Collection Practices Act (FDCPA) provides protection to consumers against abusive, deceptive, or unfair debt collection practices. FDCPA governs collection activities conducted by: (1) third-party collection agencies collecting on behalf of lenders; (2) lenders collecting their own debt using an assumed name, to suggest that a third person is collecting or attempting to collect such debt; and (3) any collection agency that acquires the debt if the collector acquired the debt when it already was in default.

#### ***Fair Credit Reporting Act***

The Fair Credit Reporting Act (FCRA) and its implementing regulations require that furnishers of information to consumer reporting agencies ensure the accuracy of data placed in the consumer reporting system.

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Additionally, FCRA prohibits the use of consumer reports for impermissible purposes, and it requires users of consumer reports to provide certain disclosures to consumers. FCRA also limits certain information sharing between affiliated companies.

### *The Gramm-Leach-Bliley Act*

The Gramm-Leach-Bliley Act (GLBA) and its implementing regulations, among other things, prohibits a financial institution from disclosing nonpublic personal information about a consumer to non-affiliated third parties, unless certain conditions are met.

### *Equal Credit Opportunity Act*

The Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, prohibit discrimination in any aspect of a credit transaction and set forth requirements for accepting applications and providing notice of any adverse action.

### **Supervisory Guidance**

#### ***Interagency Lending Principles for Offering Responsible Small-Dollar Loans***

The [\*Interagency Lending Principles for Offering Responsible Small-Dollar Loans \(FIL-58-2020\)\*](#) (Principles) encourage institutions to offer responsible small-dollar loans to customers for both consumer and small business purposes. The Principles note that FDIC supervised institutions are well-suited to meet customers' credit needs with well-designed small-dollar loan programs that can result in successful repayment outcomes, facilitate a customer's ability to demonstrate positive credit behavior, and transition customers into other financial products.

The Principles note that responsible small-dollar loans generally reflect the following characteristics:

- 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;
- 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.

Core lending principles for financial institutions that offer small-dollar loan products include:

- Offering loan products that are consistent with safe and sound banking, treating customers fairly, and complying with applicable laws and regulations;

- Effectively managing the risks associated with the products they offer, including credit, operational, and compliance; and
- Ensuring that loan products are underwritten based on prudent policies and practices governing the amounts borrowed, frequency of borrowing, and repayment requirements.

The Principles also note that reasonable loan policies, practices, and controls for responsible small-dollar lending would generally address certain elements related to loan structures, pricing, underwriting, marketing and disclosures, and servicing and safeguards. Effective compliance management may include new product development protocols that address, among other issues, the clear disclosure 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.

### ***FDIC Supervisory Policy on Predatory Lending***

The [\*FDIC's Supervisory Policy on Predatory Lending \(FIL-6-2007\)\*](#) describes certain loan characteristics of predatory lending, reaffirms the FDIC's position that such activities are inconsistent with safe and sound lending, and discusses practices that may violate certain consumer protection laws and regulations. There is no simple checklist for determining whether a particular loan or loan program is predatory. Loan terms that are helpful to one borrower may be harmful to others. Signs of predatory lending include the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a borrower represents.

FIL-6-2007 notes that predatory lending typically involves at least one, and perhaps all, of the following elements:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay the obligation.
- Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced.
- Engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower.

FIL-6-2007 notes that predatory lending harms individuals and communities and raises risk management and consumer compliance concerns for financial institutions.

***Interagency Expanded Guidance for Subprime Lending Programs***

The [Interagency Expanded Guidance for Subprime Lending Programs, \(FIL-9-2001\)](#) addresses the examination of institutions that systematically target the subprime market through programs that employ tailored marketing, underwriting standards, and risk selection. This expanded guidance applies specifically to those institutions that have subprime lending programs with an aggregate credit exposure greater than or equal to 25 percent of tier 1 capital. The term "subprime," as used in the guidance, refers to the credit characteristics of individual borrowers. Subprime borrowers typically have weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Among other things, the guidance discusses portfolio-level reviews and transaction-level testing. The guidance also addresses predatory or abusive lending practices.