It's Time for a Fintech to Help Bank on Small-Dollar Lending in the U.S.

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As the U.S. wrestles with COVID-19, federal banking agencies are encouraging banks and credit unions to make responsible small-dollar loans to consumers and small businesses. Partnering with a financial technology company ("fintech") that offers innovative technologies and alternative underwriting processes can help make it happen.

On May 20, 2020, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency issued guidance ("Guidance") encouraging banks and credit unions to offer responsible small-dollar loans. Small-dollar loans can provide liquidity lifelines to those facing cash-flow imbalances; unexpected expenses, emergencies, or disasters; or disruptions in work or income. The Guidance continues the shift in recent years away from prior policies aimed at curtailing access to predatory small-dollar loans, and it follows on the heels of similar encouragements issued by federal banking agencies during recent months. Underscoring this shift, the Consumer Financial Protection Bureau on May 22, 2020 announced a template that banks and credit unions within its jurisdiction can use to apply for no-action letters covering their small-dollar loan products.

Liquidity support products, such as small-dollar loans, are in demand. According to the most recent annual Survey of Household Economics & Decisionmaking by the Board of Governors of the Federal Reserve System, 37% of adults would have difficulty covering a hypothetical unexpected expense or emergency of only $400 (e.g., a car repair, home repair, or medical bill); however, only 3% of respondents indicated that they would use a bank loan or line of credit to attempt to cover such an expense. *See* Board of Governors of the Federal Reserve System, Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020, 21-22 (May 2020).

While historically the small-dollar loan segment has been associated with deposit advances or payday loans, small-dollar loans can include a variety of open-end lines of credit and closed-end loans with single or installment payment structures of various durations.

The Guidance notes that fintech-bank partnerships are an effective way for banks to deliver consumer-friendly small-dollar loans via innovative technology and alternative underwriting, and expresses the agencies' views that:

- New underwriting processes, technologies, and automation can lower the cost of providing responsible small-dollar loans.
- Alternative underwriting information, such as deposit account activity, may facilitate credit offers to underserved or credit-invisible customers or customers temporarily impacted by natural disasters, national emergencies, or economic downturns.
- Small-dollar loan features and servicing processes should promote borrower affordability and successful repayment in a reasonable time frame, avoiding cycles of debt and high costs due to reborrowing or rollovers.
- Customers experiencing distress or unexpected circumstances may achieve successful repayment through timely and reasonable workout strategies or restructurings.

These points resemble a fintech's mission statement, and fintechs are already leading the charge. For example, efficient customer acquisition and onboarding solutions are well-established services offered by fintechs. Fintech lenders are deploying a variety of approaches to alternative underwriting, which enable banks and credit unions to offer more favorable loan terms to underserved borrowers, and creative financing solutions. For example, some fintechs are already providing employees on-demand access to their unpaid earnings for less than the cost of an ATM fee, and others are providing innovative low-cost, non-recourse invoice factoring for small businesses. As for loan servicing, fintechs can offer servicing solutions that are custom-tailored to borrowers' individual circumstances.

The Guidance reminds banks and credit unions to effectively manage the risks presented by the use of new technologies, alternative underwriting, and third-party arrangements.

Opportunities to connect with and support customers through successful small-dollar relationships can lead to expanded and larger customer relationships down the road. Fintechs boasting a variety of innovative solutions that mitigate risk and provide cutting-edge customer experiences offer compelling partnership opportunities for banks and credit unions looking to re-enter and recapture the small-dollar space.

Our Fintech Practice advises banks and credit unions on developing and running fintech lending, payments, and savings partnerships. We also counsel fintechs entering and administering these partnerships.

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