



# The large need for small-dollar lending

BY KENNETH PATRICK AND DAVID POMMEREHN

*With a green light from federal authorities, banks can once again help customers meet short-term financial needs and save money.*

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In 2017, the Federal Reserve found that about 40 percent of adults wouldn't be able to pay an unexpected \$400 expense without borrowing funds or selling a personal item. Further, almost three-quarters of checking account holders in a Fiserv-sponsored survey said they need to access short-term credit resources at least once a year. Consumers say they usually require less than \$1,000—\$100 to \$499 is typical—and unexpected auto and home repairs along with health care costs most frequently precipitate the need.

Every week in the news we hear of another study or survey that concludes the same thing: Despite the growing economy, millions of Americans still have difficulty accessing cash when they need it the most.

So what will your account holders do if—or more likely when—they encounter a costly medical expense, leaky roof or need a new tires to drive to work (where they earn their money in the first place)?

#### **SMALL-DOLLAR LENDING: PROVEN SUCCESS, DISCONTINUED PRODUCTS**

Before 2013, some struggling Americans turned to short-term, small-dollar bank loans. Historically, federal banking regulators encouraged banks to help finance these needs and some banks did so with products connected to the customer's deposit account. This centered on carefully designed lines of credit, primarily based on account history, with excess-use safeguards and reasonable terms for consumers and

banks. These products were well understood, well-liked by consumers who used them, and provided an important credit source of short-term liquidity.

But in 2013, the Office of the Comptroller of Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) proposed strict guidelines for banks that offered deposit account-based solutions. This involved stringent underwriting requirements and regulatory hurdles to preclude banks from offering customers these products. With this development, banks had little opportunity to offer their solutions at a reasonable cost. Most discontinued their products.

While the product went away, the need did not. Sadly, this regulatory change drove Americans to pawnshops, title loan businesses, check cashers and other high cost-installment lenders. The need for cash flow still prevailed; the option to use their trusted bank did not.



Since then, the *single-payment credit market has grown from \$7.4 billion to \$39.4 billion*, with alternative lenders dominating it. In May 2018, [the OCC lifted restrictions from the 2013 guidelines](#) and banks are now encouraged to create innovative solutions that provide responsible short-term, small-dollar credit to consumers. The FDIC guidance remains in place but is currently under review—along with a rule issued by the Bureau of Consumer Financial Protection late last year.

#### **WHY CONSUMERS BENEFIT**

By offering short-term lines of credit or loans to be paid back within 90 days—generally under \$1,000, though they can range up to \$5,000—financial institutions can assist customers who need a quick, convenient way to bridge their liquidity needs. These loans or lines of credit are primarily qualified on deposit account history.

As for the benefits, they:

*» Protect consumers from the “debt trap”: The financial institution’s strict regulatory environment means loans will be evaluated individually for the borrower’s ability to repay; limited to include “cooling off periods”; inclusive of significant disclosures, ensuring borrowers understand repayment terms; and managed within the banking environment. This avoids the aggressive collection cycle of alternative lenders where the borrower, automatically charged for the loan, often incurs overdraft fees.*





- » *Provide a secure service at a reasonable cost: Though the regulatory and compliance burden is higher for financial institutions, they can offer lower fees than payday lenders and other options.*
- » *Safeguard personally identifiable information (PII): With an existing bank relationship, no PII needs to be provided or transmitted. This avoids identity theft risk.*
- » *Open opportunities for other credit options: These loans/lines can help consumers qualify for more mainstream credit products.*

Given a description of a deposit account-based product, nearly 70 percent of consumers in the Fiserv survey said they'd be interested in the program as a quick way to access emergency funds. Further, consumers say the product's bank origin represents one of its most compelling features, along with features such as easy enrollment and lower fees.

#### **HOW FINANCIAL INSTITUTIONS BENEFIT, TOO**

Financial institutions that offer the service can increase account holder share of wallet, advance the customer experience and deepen the customer re-

lationship. Such a market differentiation can drive new account acquisition—while existing account retention and increased balances advance deposit growth goals.

[Speaking to CNBC](#), [Alex Horowitz](#), senior research officer for the consumer finance project at Pew Charitable Trusts, predicted that financial institutions could likely fare better with these products than they did pre-2013. This is thanks to advancements from third-party providers that focus on building tools to compete in this new, fintech-heavy environment. Their service takes analysis out of the hands of bank employees and automates the entire process. Most services would originate online or through a mobile app—saving time and increasing the accuracy of repayment analysis.

While the benefits alone should motivate financial institutions to offer these loans, there is also great value in supporting the financial health of Americans. Many financial institutions make it part of their overall mission to provide account holders solutions to meet all their financial needs.

What solutions stand out as priorities for your financial institution? For consumers and banks alike, small-dollar lending promises to make a big impact: one that literally lends itself to a closer look. [➤](#)

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