

CFPB Issues Innovative No-Action Letter Template to Reduce Regulatory Uncertainty for Banks Offering Small-Dollar Credit Products

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Financial Services

Today, May 22, the Consumer Financial Protection Bureau (“CFPB”) [issued](#) an important [no-action letter template](#) in response to an [application](#) by the Bank Policy Institute (“BPI”), which could serve as the basis for no-action letter applications by BPI members and other deposit-taking institutions that wish to offer a standardized, small-dollar credit product as described in the application. The CFPB’s issuance of this no-action letter template (the “Small-Dollar Credit Template”) follows the federal banking agencies’ May 20 [release of *Interagency Lending Principles*](#) for responsible small-dollar loans, and is intended to complement other recent [expressions of encouragement](#) for depository institutions to engage in responsible small-dollar lending. The Small-Dollar Credit Template provides a new mechanism by which depository institutions may obtain a no-action letter from the CFPB that addresses the application of the Dodd-Frank Act’s prohibition on unfair, deceptive, and abusive acts and practices (“UDAAP”) to described aspects of their particular small-dollar lending products (the “Applicant’s Product”). The CFPB’s issuance of the Small-Dollar Credit Template should provide depository institutions that wish to offer small-dollar lending products with a new and expedited path to addressing the potential regulatory uncertainty and risks associated with those products.

Covington & Burling LLP represented BPI in its application for the Small-Dollar Credit Template issued today.

The CFPB’s No-Action Letter Framework

The Small-Dollar Credit Template was issued pursuant to the CFPB’s 2019 [Policy on No-Action Letters](#) (the “Policy”), which provides a framework for reducing regulatory uncertainty with respect to an innovative product or service through a statement that the CFPB will not make supervisory findings or bring a supervisory or enforcement action against the company for offering the described aspects of the product or service. The Policy not only provides a process for individual financial institutions to seek and obtain no-action letters, but it also permits a service provider or facilitator (e.g., a trade association, consumer group, or other third party) to seek a no-action letter *template*, pursuant to which the CFPB states its intention to grant subsequent applications for no-action letters in appropriate cases where the applicant provides certain, specified certifications and related supplemental information. Under the Policy, each no-action letter has a limited scope and applies only to “described aspects of the product or service,” requiring applicants to describe both the product or service in question, and the

manner in which it is offered or provided. Although a no-action letter template is not independently binding, it provides a unique mechanism and path for clarifying and expediting the issuance of binding no-action letters to individual institutions that wish to offer products or services consistent with the scope of the no-action letter template.

The BPI Application for the Small-Dollar Credit Template

The CFPB issued the Small-Dollar Credit Template in response to an [application](#) that BPI filed with the CFPB (the “BPI Application”) for a non-action letter template that could serve as the basis for subsequent no-action letter applications by BPI members and other deposit-taking institutions subject to the CFPB’s supervisory and enforcement authority¹ that intend to offer a standardized, small-dollar credit product as described in the BPI Application (the “Proposed Product”). The BPI Application describes the general structure and features of the Proposed Product, many of which are quite definite and intended to function as “guardrails” that must be included in any version of the Proposed Product for which an individual depository institution might seek its own no-action letter under the Small-Dollar Credit Template. At a high level, the Proposed Product contemplates a loan that is:

- Small-dollar in nature (i.e., \$2,500 or less);
- Structured either as an installment loan or as a line of credit;
- Linked to a borrower’s deposit account at the applicant;
- Underwritten based on criteria including the borrower’s transaction activity in his or her accounts with the applicant (i.e., “cash flow” underwriting); and
- Subject to a range of specific protections with respect to repayment structures, mitigating “rollover” risks, and prohibiting late payment and prepayment fees.

The BPI Application explains that applicants for no-action letters under the Small-Dollar Credit Template would design a version of the Proposed Product that includes the guardrails, but also would provide further specific information regarding the precise nature and details of the individual version of the Proposed Product the applicants intend to offer, including the manner in which it would be offered and provided. Such specific details would depend on a variety of factors, including the applicant’s business strategy, risk tolerance, underwriting criteria, and customer needs. Thus, the Small-Dollar Credit Template covers many, but not all, of the key terms and conditions of the Proposed Product. Importantly, neither the BPI Application nor the Small-Dollar Credit Template addresses the potential interest rate or other fees associated with the Proposed Product; these details must be included and addressed on an applicant-specific basis in any underlying request for no-action relief under the Small-Dollar Credit Template.

The Small-Dollar Credit Template

The [Small-Dollar Credit Template](#) sets forth a clear framework pursuant to which depository institutions wishing to offer their own versions of the Proposed Product may apply for and obtain their own no-action letter to address the application of UDAAP to described aspects of their

¹ Consistent with the limitations on the Bureau’s supervisory and enforcement jurisdiction set forth in Dodd-Frank Act section 1026, the Small-Dollar Credit Template refers to “DI Applicants” that are insured depository institutions and insured credit unions with total assets of more than \$10,000,000,000 and affiliates of such entities that are themselves insured depository institutions or insured credit unions. 12 U.S.C. §§ 5515, 5516.

particular small-dollar lending products. That framework has two key components. First, the application must provide a number of “guardrail” certifications that confirm that the Applicant’s Product is consistent with that described in the BPI Application and the Small-Dollar Credit Template. Second, the application must include additional information about other specific features and practices, which the CFPB will evaluate as part of its review of each application submitted under the Small-Dollar Credit Template.

As noted above, the Small-Dollar Credit Template itself is non-operative and non-binding; only subsequent no-action letters issued under the Small-Dollar Credit Template would be operative and binding on the CFPB.

Guardrail Certifications

Under the Small-Dollar Credit Template, applications for individual no-action letters must include the following certifications, consistent with the BPI Application:

1. Status. The applicant must be an insured depository institution or insured credit union with total assets greater than \$10,000,000,000, or an insured depository institution or insured credit union affiliated with such an entity (consistent with the scope of the CFPB’s supervisory and enforcement authority).
2. Eligibility. The Applicant’s Product is offered and provided only to consumers who hold a deposit account with the applicant.
3. Product Structure. The Applicant’s Product is structured as either (i) a fixed-term, amortizing small-dollar installment loan, which the customer would pay back in fixed minimum payment amounts over the term of the loan; or (ii) an open-end line of credit, which would be linked to a customer’s associated deposit account with the DI Applicant, and amounts drawn under the line would have a fixed repayment period, to be repaid by the customer in fixed minimum payment amounts over that period.²
4. Dollar Amount. The Applicant’s Product does not exceed \$2,500.
5. Repayment Term and Structure.
 - a. Where the Applicant’s Product is structured as an installment loan: (i) the repayment term is more than forty-five days and less than one year; and (ii) payments are amortized on a straight-line basis across more than one payment.
 - b. Where the Applicant’s Product is structured as a line of credit: (i) the repayment term for each draw is more than forty-five days and less than one year; and (ii) payments for each draw are amortized on a straight-line basis across more than one payment, except in the case of any single-payment loans as described in the next sentence. If a repayment structure includes a repayment term of forty-five days or less and a single payment is utilized, it will be limited to cases where a draw is no more than ten percent of the maximum dollar amount established for the Applicant’s Product.

² Depository institutions would not offer the line of credit version of the proposed product by means of a credit card.

6. No Balloon Payments. None of the required payments under the Applicant's Product are more than twice as large as any other required payment.
7. Rollovers. Rollovers (i.e., the extension or renewal of a loan or draw on which a scheduled payment has not been made, for an additional fee) are prohibited. Nor would a borrower be eligible to receive a new loan or draw to repay an outstanding balance associated with a prior loan or draw. Furthermore, a borrower with an existing loan or draw is not eligible to receive a new loan or draw until the existing loan or draw is fully repaid.
8. Underwriting. Underwriting for the Applicant's Product includes the consumer's transaction activity in their accounts with the applicant, also known as "cash flow" underwriting.
9. Collateral. Borrowers are not required to provide collateral or any other security to take out the Applicant's Product. (The applicant may retain a right to set-off to the extent doing so is consistent with applicable law and regulation.)
10. Costs and Fees. No late payment fees or prepayment penalties are charged with respect to the Applicant's Product.
11. Disbursement. Funds (whether in the form of an installment loan or draw on a line of credit) are disbursed into the borrower's deposit account with the applicant within three to five business days after the borrower is approved for the Applicant's Product.
12. Disclosures. Consumer disclosures and marketing materials associated with the Applicant's Product are designed to meet the requirements of all applicable state and federal consumer financial protection and other laws, and, where appropriate, are shortened and modified for consumers' ease of use and readability for online and mobile channels.
13. Servicing. The Applicant's Product is serviced by the applicant, not a third party.

The Small-Dollar Credit Template expressly notes that some of these guardrails may extend beyond the requirements of applicable laws and regulations, and that the inclusion of any particular guardrail should not be interpreted as a statement by the CFPB that small-dollar credit products must contain such guardrails to avoid violating the law.

Additional Information About Features and Practices

Under the Small-Dollar Credit Template, applications for individual no-action letters must also include the following additional information about certain features and practices, which are not specified in the BPI Application:

1. APR. The anticipated Annual Percentage Rate ("APR") range of the Applicant's Product, as well as a description of how that range is calculated, including any and all fees and costs included in the calculation. A description of how the anticipated APR range, combined with other terms and conditions, would improve the options available to consumers within the market for the Applicant's Product.
2. Other Fees. A description of any fees other than the fees included in the calculation of the APR range. A description of how such fees, combined with other terms and conditions, would improve the options available to consumers within the market for the Applicant's Product.

3. Repayment Term and Structure. A description of any aspect of the repayment term and structure for the Applicant's Product more specific than the repayment term and structure specified in the guardrail certification regarding repayment term and structure above.
4. Reborrowing Risk Mitigation. A description of how the applicant intends to mitigate reborrowing risk (in addition to underwriting and the prohibition on rollovers, etc., described above), such as through using mechanisms such as "cooling off" periods, periodic borrowing limits, "off ramps," and/or similar measures.
5. Underwriting. A description of the underwriting criteria used for the Applicant's Product, including eligibility and credit decisioning criteria, including the extent to which the underwriting is streamlined relative to other identified underwriting processes.
6. Marketing. A description of how the applicant intends to market the Applicant's Product.
7. Application Process. A description of the process for applying for the Applicant's Product, including the extent to which the process is streamlined relative to other application processes.
8. Credit Reporting. A description of any information the applicant intends to provide to credit reporting agencies, such as information about payment and non-payment.
9. Other Features and/or Practices. A description of (i) any features of the Applicant's Product and the manner in which it is offered or provided (in addition to those listed above), and/or (ii) any acts or practices associated with offering or providing the Applicant's Product (in addition to those listed above) that the applicant wishes to be included within the scope of a potential no-action letter.

Potential Applications Under the Small-Dollar Credit Template

The Small-Dollar Credit Template should provide an important and appealing path to greater regulatory certainty for depository institutions or credit unions wishing to offer small-dollar credit products. Particularly important is the fact that the Small-Dollar Credit Template specifically addresses the application to small-dollar credit products of the Dodd-Frank Act's UDAAP prohibition, regulatory uncertainty around which has served as a major disincentive to deposit-taking institutions that might otherwise consider offering such products. To avail themselves of the greater regulatory certainty provided under the Small-Dollar Credit Template, however, individual depository institutions wishing to offer such products must take additional steps to apply for and receive individual, binding no-action letters that specifically address the Applicant's Product. For further details on the no-action letter application process, please see Covington's *Model No-Action Letter Application [toolkit](#)*, which provides detailed instructions and models for required documents.

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Covington & Burling LLP's Financial Services attorneys have deep experience guiding U.S. and non-U.S. financial institutions through the most challenging circumstances, including the 2008–09 financial crisis. Our team, which includes former senior federal regulators, stands ready to advise financial institutions as they navigate the impact of COVID-19 on the economy and the financial markets.

If you have any questions concerning the material discussed in this client alert, please contact the members of our Financial Services practice below.

Financial Services

<u>Eric Mogilnicki</u>	+1 202 662 5584	emogilnicki@cov.com
<u>Jeremy Newell</u>	+1 202 662 5569	jnewell@cov.com
<u>Michael Nonaka</u>	+1 202 662 5727	mnonaka@cov.com
<u>D. Jean Veta</u>	+1 202 662 5294	iveta@cov.com
<u>Karen Solomon</u>	+1 202 662 5489	ksolomon@cov.com
<u>David Stein</u>	+1 202 662 5074	dstein@cov.com
<u>Lucille Bartholomew</u>	+1 202 662 5079	lbartholomew@cov.com
<u>Randy Benjenk</u>	+1 202 662 5041	rbenjenk@cov.com
<u>Jenny Konko</u>	+1 202 662 5025	jkonko@cov.com

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