Consumer Financial Services Webinar Series

Webinar #4:

Building a Small-Dollar Loan Product
September 15, 2015   1:00 – 2:00 PM ET
Agenda

• NEXT Awards and Consumer Financial Services Webinar Series

• Review CFSI’s *Compass Guide to Small-Dollar Credit*

• Review CFPB’s Proposed Framework for Small Dollar Credit

• Q&A
Presenters

Beth Lipson, EVP, Strategic Initiatives
Opportunity Finance Network

Tanya Ladha, Manager
Center for Financial Services Innovation
2015 NEXT Awards and Consumer Financial Services Webinar Series

• Year-long Awards program

• Goals
  – Take CDFIs to the next level of growth and impact
  – Increase visibility of CDFIs and the work they do
  – Combine financial support, visibility, learning, and sharing

• 2012-2016 theme of expanding coverage
  – 2015 subtheme: consumer financial services

• The Consumer Financial Services Webinar Series to set the context for and support the theme of consumer financial services
Past webinars:

- Webinar #1: Current Trends in Consumer Behavior and Financial Products
- Webinar #2: Lessons Learned in Developing, Innovating, and Scaling Consumer Financial Products and Services
- Webinar #3: Strengthening CDFI Borrowers through Credit Reporting

Webinar series sponsored by Prudential

Listen to the webinar recordings at nextawards.org/awards
The Center for Financial Services Innovation is the authority on consumer financial health, leading a network of financial services innovators committed to building better consumer products and practices.

### Using our Compass Principles as a framework for quality, we:

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<th>Connect</th>
<th>Inform</th>
<th>Innovate</th>
<th>Advise</th>
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<td>We foster dialogue and collaboration through CFSI events and networking opportunities.</td>
<td>We provide deep consumer insights and industry research.</td>
<td>We seed and test promising new ideas.</td>
<td>We offer consulting services to both for-profit and nonprofit providers.</td>
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The Compass Principles

- Create Opportunity
- Embrace Inclusion
- Build Trust
- Promote Success
Defining Quality in Small-Dollar Credit

The Compass Guide to Small-Dollar Credit (2014) defines a high-quality small-dollar loan:

- **1.** Is made with a high confidence in the borrower's ability to repay.
- **2.** Is structured to support repayment.
- **3.** Is priced to align profitability for the provider with success for the borrower.
- **4.** Creates opportunities for upward mobility and greater financial health.
- **5.** Has transparent marketing, communications and disclosures.
- **6.** Is accessible and convenient.
- **7.** Provides support and rights for borrowers.

Each guideline has corresponding, recommended practices that are divided into three categories:

- **Core**
- **Stretch**
- **Next Generation**
Compass Principles to Small-Dollar Credit

Is made with a high confidence in the borrower’s ability to repay.

Core

• Use underwriting criteria ensuring borrower’s ability to repay without re-borrowing while meeting basic financial need
• Do not rely solely on collateral for repayment
• Offer a loan based on borrower’s need and lender’s risk tolerance
• Monitor portfolio performance, ensuring borrowers are not defaulting or re-borrowing
Compass Principles to Small-Dollar Credit

Core
- Design repayment timing to support repayment
- Create meaningful safeguards to prevent misuse or overuse of product
- Provide support to borrower if/when they have trouble repaying

Stretch
- Allow flexible repayment schedules that match income schedules
- Allow customized loan amounts, terms and payments to fit a borrower’s budget, within ranges that underwriting suggests a borrower can afford

Next Generation
- Provide customizable alerts and tools that help borrowers manage their debt
Compass Principles to Small-Dollar Credit

**Core**
- Price loans to reward positive behavior, lowering costs or increasing benefits over time
- Do not rely on penalty or refinancing fees as profit drivers
- Ensure borrowers receive the lowest-priced and most appropriate loan for which they qualify

**Next Generation**
- Provide additional benefits to borrowers who demonstrate positive behavior
Compass Principles to Small-Dollar Credit

Core
- Help borrower leverage successful repayment into better credit opportunities
- If borrower doesn’t qualify today, provide actionable and specific next steps
- Leverage key moments to provide guidance on successful use of products

Stretch
- Provide borrowers with their credit score information throughout life of loan, demonstrating impact of repayment

Next Generation
- Combine SDC with savings opportunities and incentives, helping borrowers plan for future liquidity shortfalls
Compass Principles to Small-Dollar Credit

Core

• Disclose full cost of the loan to borrower in simple, clear and easy-to-understand language (no hidden fees, jargon or fine print)
• Provide loan information in a manner that is understandable to the borrower, encouraging more informed decisions

Stretch

• Illustrate, in real time, how much the loan will cost and how long it will take to pay off
Compass Principles to Small-Dollar Credit

6. Is accessible and convenient.

Core
• Make loan decisions in a timely manner, balancing borrower’s need and lender’s commitment to responsible underwriting
• Ensure loan application, decision, disbursement and servicing processes are convenient and culturally relevant

Stretch
• Use nontraditional delivery channels to increase access for the borrower
Compass Principles to Small-Dollar Credit

Core
- Ensure customer support is easily accessible and borrowers are treated respectfully and helpfully
- Design dispute resolution and collection practices that are reasonable and fair
CFPB’S FRAMEWORK FOR REGULATING SMALL DOLLAR CREDIT
Review and Discussion
CFPB SDC Timeline

• **March 2015**
  • CFPB announces that it will consider proposing rules to end payday traps by
    • Requiring lenders to confirm “ability-to-repay”
    • Restricting collection methods to avoid excessive fees
    • Regulating payday loans, vehicle title loans, deposit advance products and certain high-cost installment and open-end loans

• **April 2015**
  • CFPB held a meeting with a panel of small lenders, required under the Small Business Regulatory Enforcement Fairness Act (SBREFA)

• **End of 2015**
  • Current plans are to issue a notice of proposed rule-making by the end of 2015. Once the Bureau issues its proposed regulations, the public will be invited to submit written comments which will be carefully considered before final regulations are issued.
General Take-Aways

- Framework defines short-term (45 days or less) and longer-term (more than 45 days).
- The proposed framework covers short-term (45 days or less) and longer-term (more than 45 days).
- It addresses how lenders collect payments (e.g., direct withdrawal from bank accounts).
- It covers payday loans, deposit advance products, vehicle title loans, high-cost installment loans, and open-end lines of credit and other loans, “regardless of how they are named or marketed to consumers.”
- In a break from tradition, the Bureau is proposing two different compliance paths. Under the proposed frameworks, lenders can comply with the rules by meeting guidelines for either:
  - Prevention – determining at the outset that consumers can pay off the loans when due, or
  - Protection – limiting the number of loans in a row consumers can take out
- Note that lenders do not need to both prevent and protect – they can prevent or protect, and will be considered to be in compliance.
- This proposed framework will be considered by the Small Business Review Panel under the Small Business Regulatory Enforcement Fairness Act (SBREFA).
- While the Bureau is not allowed to set interest rates, they have leveraged the existing Military Lending Act’s 36% and the NCUA’s 28%/20 fee guidelines.
Short Term

Prevention requirements

• Lender must determine at the outset the consumer’s ability to repay the loan when due without the need to reborrow (note that this fits with our Compass Guide to Small-Dollar Credit) – this means verifying income, major financial obligations, and borrowing history (i.e., underwriting).

• Consumers can only have one loan at a time from the lender.

• To prevent consumers from becoming stuck in a cycle of borrowing, there would be a 60-day cooling off period between loans.
  – To make another loan within the 60-day window, lenders would need to document changes in ability to repay (e.g., income has increased).
  – After 3 loans in a row, lenders are prohibited from making another short-term loan for 60 days.
Protection requirements

- Loan cannot exceed $500, carry more than one finance charge, or require a vehicle as collateral.
- Consumers can only have one loan at a time from the lender.
- Rollovers are capped at 2 – 3 loans total – followed by mandatory 60-day cooling off period. Second and third loans are only allowed if the lender offers an affordable way out of debt, either via
  - A 3-loan sequence with decreasing principal for each loan, fully repaid when the 3rd loan is due, or
  - A no-cost “off ramp,” allowing the consumer to pay off the loan without further fees.
- Consumers can only spend 90 days in debt over 12 months.
Longer Term

Prevention requirements

• The same as for short-term loans, lender must determine at the outset the consumer’s ability to repay the loan when due without the need to reborrow – this means verifying income, major financial obligations, and borrowing history (i.e., underwriting).

• Lender must assess ability to repay each time the consumer wants to re-borrow or refinance.

• If the consumer is delinquent, the lender cannot simply refinance the consumer into a loan with similar terms without documenting improvements in the consumer’s financial circumstances so as to be able to repay.
Longer Term

Protection requirements
• The CFPB is considering two approaches – the NCUA standard or the 5% of income standard.

NCUA standard
• Loan amount limited between $200 and $1,000 and payments are amortizing.
• Maximum interest rate is 28% and maximum application fee is $20.
• The consumer has no other loans with the lender.
• Limited to 2 of these loans within 6 months and the consumer can only have one at a time.

5% of income standard
• Monthly payment is no more that 5% of the consumer’s gross monthly income.
• The consumer has no other loans with the lender.
• Limited to 2 of these loans to the consumer in 12 months.
CFSI Research

Small-Dollar Credit Publications

• Design Matters: Learning from Consumers’ Experiences with Small-Dollar Loans (2014)
• Know Your Borrower: The Four Need Cases of Small-Dollar Credit Consumers (2013)
• A Complex Portrait: An Examination of Small-Dollar Credit Consumer (2012)
• A Fundamental Need: Small-Dollar, Short-Term Credit (2008)

Download these reports and more
bit.ly/SmallDollarCredit
More at the OFN Conference

• OFN’s 2015 Annual Conference in Detroit will feature a session on small-dollar loan products on **Tuesday, November 10**

• Hear from CDFIs about actual products they have developed and launched

• Learn more and register at [conference.ofn.org](http://conference.ofn.org)
Q&A

Type questions into the question box located in your GoToWebinar panel.