April 15, 2009

By Fax (202-874-4950) and First Class Mail
The Honorable John C. Dugan
Comptroller
Office of the Comptroller of the Currency
250 E Street, NW
Washington, DC 20219-0001

Dear Comptroller Dugan,

The undersigned groups request that your office take action to establish meaningful third-party supervision requirements for national banks that partner with tax preparers to make refund anticipation loans (RALs)   A recent ruling by the FDIC establishes a new standard requiring banks to supervise and monitor their partner tax preparers for compliance with safety and soundness and consumer protection laws. This ruling should be adopted by the OCC for the national banks engaged in RAL lending.

A. The FDIC Has Established the Necessary Standard for Supervision and Oversight of Third-Party Agents for Banks Offering RALs.

As a board member of the FDIC, you are aware of the recent cease and desist order for Republic Bank of Louisville Kentucky issued February 10, 2009. The order can be reviewed at http://www.fdic.gov/bank/individual/enforcement/2009-02-10.pdf

Republic Bank has $3.9 billion in assets, 45 branches and offers tax-related financial products including RALs for Jackson Hewitt and hundreds of independent tax preparers. In addition to mandating greater board oversight of management, the FDIC order has four primary requirements that detail a substantive standard for banks providing RALs and other tax financial products.

- Hiring qualified management, developing an overall compliance plan, and a developing business plan for its Tax Refund Solutions (TRS) program including

RALs. The plans must be submitted to the FDIC's Chicago Regional Office for review.

- Establishing a training program about all relevant consumer protection laws for all Electronic Refund Originators (i.e., tax preparers) and contractors who communicate with customers about RAL services.

- Hiring an external auditor to evaluate tax preparers for their compliance with all consumer law protections. At least 10% of tax preparers who offer Republic RALs and who were not evaluated in a prior year must be evaluated each year.

- Hiring an external auditor to evaluate the bank's compliance with the Order and all relevant consumer compliance laws for its TRS program including RALs, twice a year.

In summary, these orders establish clear guidelines that a RAL lending bank should have adequate management and compliance for its RAL programs; that the bank must ensure that the tax preparers who offer its RALs are trained and qualified; that the bank must audit at least 10% of these tax preparers annually; and that the bank's RAL operations must be audited by an external source.

B. The OCC Should Adopt the Standard Set by the FDIC for National Banks.

While the FDIC has supervisory responsibility for Republic Bank, the OCC has that responsibility for the three other banks with the large RAL lending operations – HSBC, JPMorgan Chase and Santa Barbara Bank and Trust (SBBT). In particular, SBBT and parent company Pacific Capital Bancorp (PCB) are comparable to Republic Bank. PCB has $7.4 billion in assets, 48 branches and provides tax financial products and RALs. Like Republic Bank, it also partners with Jackson Hewitt and hundreds of independent tax preparers that provide RALs.

In reviewing prior public evaluations of PCB by the OCC, there is a notable absence of a similar standard of accountability for PCB that the FDIC has established for Republic Bank. For example, in 2004, the OCC's CRA evaluation of PCB makes no mention of the bank's tax financial products or RAL program. In the July, 2005, the OCC approved a merger for Pacific Capital Bank. In response to concerns raised by community groups regarding RALs, the OCC recited the bank's response and added its own analysis:

> As a part of the OCC's ongoing supervision of PCB within the past year, the OCC has reviewed the bank's RAL program. While the OCC found no violations of law, the OCC did recommend that the bank improve its processes for oversight of third party tax preparers. PCB has committed to address this issue.
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> PCB represented that it enters into written agreements with tax preparers that require compliance with guidelines designed to assure fair treatment of prospective borrowers. PCB provides tax preparers with training materials governing how RALs

> should be offered. It also reviews consumer complaints and conducts random audits requesting documentation. Tax preparers that have not adhered to PCB's standards may be suspended or terminated from participating in the RAL program. PCB plans to enhance its ongoing monitoring by hiring independent firms to conduct on-site visits to tax preparers. The OCC will continue to monitor PCB's commitment to improve its processes to guard against predatory lending practices by third parties.

OCC Corporate Decision #2005-11, http://www.occ.treas.gov/interp/aug05/cd05-11.

Despite these representations and supposed commitments from PCB, the bank failed to adequately supervise and monitor tax preparers who offered its RALs, as evidenced by the fact that its main RAL partner, Jackson Hewitt, has been repeatedly sanctioned for engaging in deceptive, misleading and even criminal conduct. In January 2007, the California Attorney General reached a $5 million settlement with Jackson Hewitt over that preparer's false and deceptive marketing of RALs from 2001 to 2004. In April 2007, the U.S. Department of Justice (DOJ) filed a complaint and injunction decree against Jackson Hewitt for engaging in a pervasive and massive tax fraud schemes that falsely claimed $70 million in tax refunds in 2006 and 2007. The complaint states that:

> … So Far/Jackson Hewitt intentionally hires inadequately educated and poorly trained individuals to become Jackson Hewitt tax return preparers. Sohail has said that his return preparers "are only short term. All they need is to be able to do data entry. A monkey can do this." …. The So Far/Jackson Hewitt instructors fail to teach all preparers critical elements related to tax return preparation, including Earned Income Tax Credit (EITC) due diligence requirements, procedures for detecting fraudulent W-2 forms, and methods to question customers who provide questionable, suspicious, or fraudulent information. In addition, the So Far/Jackson Hewitt training fails to give return preparers the knowledge or experience to complete more complicated tax returns, including those requiring Schedule A or C. This lack of training directly contributes to the preparation of inaccurate, incomplete, and false tax returns.

The complaint can be reviewed in full at http://www.usdoj.gov/tax/MI_Compl.pdf

Partly as a result of DOJ's enforcement action, PCB reported a net loss of $91.6 million from RALs according to its 2008 SEC Form 10-K filing.

Despite these law enforcement actions by the DOJ and the California Attorney General against its main RAL partner, the OCC performance evaluation for PCB covering the 2006 and 2007 years did not contain material findings on PCB's RAL business. The CRA component of the evaluation awarded the lender an outstanding rating. On page 9 one line is dedicated to consideration of consumer compliance laws. "*We found no evidence of illegal discrimination or other illegal credit practices.*"

These findings are surprising given the DOJ and California Attorney General's enforcement actions against Jackson Hewitt, which documented that Jackson Hewitt franchises with 126 offices did not train their employees and were actively committing tax fraud that utilized PCB's RALs. Given the blatant disregard for compliance with tax laws, it is hard to believe that those charged with fraud were scrupulous about compliance with the Equal Credit Opportunity Act or the Federal Trade Commission Act.

In addition to its failure to adequately supervise and monitor its tax preparer partners, PCB has admitted that its own risk management and supervision were less than robust. Until 2007, PCB has admitted that in terms of fraud control, it did nothing more than mimic the IRS's controls *and even admitted it left fraud controls off when they thought IRS wasn't screening*. PCB's CEO stated in an investor call:

> The reason why we didn't have it [fraud control] on all the time before is because we had a history with the IRS over their own fraud control and we mimicked, or tried to mimic the IRS' fraud control. So we would turn on when we thought the IRS would turn on its fraud control, and for many years, 10 or 15 years, that served this bank very, very well. It allowed the bank to balance revenue growth with loss control.[1]

Indeed, SBBT did not even employ a bank officer in its RAL division who was responsible for credit quality. As one investment analyst noted: "risk management was a little sparse."[2]

Despite the controversy of the RAL program and a history of consumer law violations and tax fraud by PCB partner tax preparers, we assume that OCC recommended that PCB receive TARP funding, since we understand that banking regulators were, as a matter of practice, making recommendations about which banks should receive such funding. The OCC's support of TARP funding for PCB, amounting to $180 million, and its lack of regulatory action, are the best indicators of the OCC regulatory oversight and policy position on refund anticipation loans. The OCC 2005-11 Decision is the best indication of the standards that the OCC holds PCB to, which is essentially self-certification of compliance. The bank requires tax preparers to sign a statement that they treat consumers fairly, and according to the bank, *"Tax preparers that have not adhered to PCB's standards may be suspended or terminated from participating in the RAL program."* It should be noted that PCB still provides RAL services to Jackson Hewitt in the 2009 tax season.

If we have misunderstood the OCC's position or its regulatory enforcement actions, please let us know.

C. The Significant Risk of Fraud Created by RALs Requires that Banks Supervise and Monitor their Third-Party Agent Tax Preparers

Consumer advocates have long criticized RALs for the expense and risk they pose for consumers, especially low-income taxpayers. However, the problems of RALs are not limited to their impact on consumers. RALs also are risky because they are often

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[1] Pacific Capital Bancorp Conference Call, Financial Disclosure Wire, October 29, 2007, at 14.
[2] *Id*. at 10.

involved in tax fraud schemes by preparers, as discussed in a recent report issued by NCLC and CFA (attached). This report summarizes numerous studies, conducted by consumer groups, private foundations, government investigators, and the IRS's own researchers, indicating that RALs promote inflated refunds.

For example, a 2008 study by IRS found that "propensity scoring methods indicate that there is a significant correlation between taxpayers who use RALs and noncompliance. RAL users are 27 percent - 36 percent more noncompliant than taxpayers who do not use a bank product."[3] A 2006 GAO study found errors that led to inflated refunds exceeding $1,000 in 6 out of the 19 test cases.[4] Mystery shopper testing conducted by consumer groups found multiple instances of tax preparation that led to inflated refunds, including a Jackson Hewitt preparer who failed to include unemployment income in a tester's return.[5]

Part of the problem is tax preparers are so thinly regulated as an industry. With the exception of only three states, there are no minimum educational, licensing, or certification requirements for tax preparers. Yet these minimally regulated preparers are acting as third party agents for banks in making RALs. They solicit customers for the loans, explain (or fail to explain) the loan terms to consumers, process loan documentation, obtain the consumer's signature, retain the loan documents on file, and even print the RAL checks. They determine the size of the loan and ensure its soundness, through their work in preparing the tax return. In short, tax preparers do everything but make the ultimate approval decision and fund the loan. Given that these preparers are not supervised by anyone else, it is even more critical that the banks for whom they are offering loans establish an oversight program.

The population of tax preparers is extremely diverse as well. In addition to H&R Block, Jackson Hewitt and Liberty Tax, there are thousands of independent preparers.
While Jackson Hewitt is the primary partner of PCB, the bank partners with hundreds of independent preparers, some of whom have even lower accountability standards. While some independent preparers are accountants, enrolled agents, or more experienced than the chains, the independent preparer sector also includes fringe preparers such as payday loan stores, check cashers, used car dealers, jewelry and furniture stores, and in immigrant communities, businesses that offer travel services, "notario" services, and quickie foreign divorces. In addition to fraud issues, the competence of these fringe preparers may be questionable.

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[3] Karen Masken, Mark Mazur, Joanne Meikle, and Roy Nord, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance*, Office of Research, Analysis and Statistics, Internal Revenue Service, 2008, at 15, on file with authors.
[4] Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T, April 4, 2006, *available at* http://www.gao.gov/new.items/d06563t.pdf.
[5] Chi Chi Wu, Kerry Smith, Peter Skillern, Adam Rust, and Stella Adams, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia*, National Consumer Law Center, Community Reinvestment Association of North Carolina, Community Legal Services of Philadelphia, April 2008, ("Durham/Philadelphia Mystery Shopper Report")

D. **Conclusion**

The business of RAL lending through minimally regulated agents such as tax preparers is fraught with risk and the potential for fraud. We urge the OCC to follow the precedent established by the FDIC in requiring the lender to:

1) Provide training for all of its tax preparer partners and their employees on consumer laws;
2) Substantively evaluate tax preparer compliance with a third party audit which is approved by the OCC
3) Audit the tax financial products program bi-annually for compliance.

In a time where the lack of adequate regulation has caused a financial crisis, we urge the OCC to exercise leadership in mandating that its banks ensure regulatory compliance by its third-party tax preparer agents.

Sincerely,

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Community Reinvestment Association of NC

Chi Chi Wu
National Consumer Law Center
(on behalf of its low-income clients)

Jean Ann Fox
Consumer Federation of America

Alan Fisher & Kimberly S. Jones
California Reinvestment Coalition

Sarah Ludwig & Josh Zinner
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