Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel

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Report No. OIG-16-001

February 2016

Federal Deposit Insurance Corporation
3501 N. Fairfax Drive, Arlington, VA. 22226
Office of Inspector General

DATE: February 19, 2016

TO: Martin J. Gruenberg
Chairman

FROM: Fred W. Gibson, Jr.
Acting Inspector General

SUBJECT: *Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel*
(Report No. OIG-16-001)

This report presents the results of our inquiry into the FDIC's supervisory approach to refund anticipation loans and the involvement of FDIC leadership and personnel in implementing that approach. My office conducted this work as a follow-on to our previously issued report entitled *The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities* (Report No. AUD-15-008).

We conducted our earlier audit at the request of 35 Members of the Congress and, in so doing, responded to your request that we conduct "a fact-finding review of the actions of FDIC staff." We communicated the results of that work to the Committee on Financial Services, U.S. House of Representatives, and the Committee requested that we provide the results of this follow-on review as well. As such, concurrent with our issuance of this report to you, we are providing a copy of the report to both the Chairman and Ranking Member of the Committee.

We have included as an Appendix to this report the written response that we received on February 17, 2016 from the Director of the Division of Risk Management Supervision and the General Counsel. Notwithstanding that response, our report raises significant issues that we continue to believe warrant your attention. We request that within 60 days, you apprise us of any actions you take after considering those issues.

Executive Summary

Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel

Report No. OIG-16-001

Why and How We Conducted This Inquiry

On December 17, 2014, Chairman Gruenberg requested that the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) conduct a "fact-finding review of the actions of FDIC staff" in the Department of Justice's Operation Choke Point. The Chairman's request was prompted by concerns raised by a letter from a member of Congress, dated December 10, 2014, asking that the role of five FDIC officials, and others as appropriate, be examined. Our office addressed the actions of the five FDIC officials in connection with Operation Choke Point in the OIG's September 2015 Report, *The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business with Merchants Associated with High-Risk Activities* (AUD-15-008) (the Audit).

In that report, the OIG indicated that it would conduct further work on the role of FDIC staff with respect to the Corporation's supervisory approach to financial institutions that offered a credit product known as a refund anticipation loan (RAL). A RAL is a particular type of loan product, typically offered through a national or local tax preparation company in conjunction with the filing of a taxpayer's income tax return.[1] Although tax preparation firms were not specifically associated with Operation Choke Point, and RALs are financial products offered by banks and not a line of business related to Operation Choke Point, information we identified in the course of the Audit raised sufficient concern to cause us to also review the FDIC's supervisory approach to institutions offering RALs and the roles of FDIC personnel in that process.

This report describes our work and findings. It is based on interviews with knowledgeable individuals and an extensive review and analysis of FDIC internal emails, correspondence, supervisory materials, and other documents.

What We Learned

The FDIC had a lengthy supervisory relationship with institutions offering RALs, dating to the 1980s. In January 2008, the then-FDIC Chairman, Sheila Bair, asked why FDIC-regulated institutions would be allowed to offer RALs.[2] Shortly thereafter, the FDIC began to try to cause banks it supervised, which are the focus of this review, to exit the business line. In late December 2010, the Office of the Comptroller of the Currency (OCC) required an institution it supervised to exit RALs effective with the 2011 tax season. During this time period, the Internal Revenue Service also withdrew access to an underwriting tool it formerly provided to tax preparers and banks that had been used to mitigate certain risks

[1] The tax preparer, sometimes referred to as an electronic refund originator (ERO), works in cooperation with the financial institution to advance a portion of the tax refund claimed by individuals in the form of a loan. Typically the loan amount would include the tax return preparation cost, other fees and a finance charge.

[2] The Chairman's question was raised in the context of an incoming letter from a number of consumer advocacy groups. This letter, together with similar correspondence in 2009, expressed concern that RALs harmed consumers.

associated with RALs. Ultimately, the FDIC caused all three of its supervised institutions that then continued to facilitate RALs to exit the business in 2011 and 2012.

RALs were, and remain, legal activities, but ultimately were seen by the FDIC as risky to the banks and potentially harmful to consumers.[3] As discussed in our report, the FDIC's articulated rationale for requiring banks to exit RALs morphed over time. The decision to cause FDIC-supervised banks to exit RALs was implemented by certain Division Directors, the [redacted] Regional Director, and their subordinates, and supported by each of the FDIC's Inside Directors. The basis for this decision was not fully transparent because the FDIC chose not to issue formal guidance on RALs, applying more generic guidance applicable to broader areas of supervisory concern. Yet the decision set in motion a series of interrelated events affecting three institutions that involved aggressive and unprecedented efforts to use the FDIC's supervisory and enforcement powers, circumvention of certain controls surrounding the exercise of enforcement power, damage to the morale of certain field examination staff, and high costs to the three impacted institutions.

The Washington Office pressured field staff to assign lower ratings in the 2010 Safety and Soundness examinations for two institutions that had RAL programs. The Washington Office also required changing related examination report narratives. In one instance a ratings downgrade appeared to be predetermined before the examination began. In another case, the downgrade further limited an institution from pursuing a strategy of acquiring failed institutions. The institution's desire to do so was then leveraged by the FDIC in its negotiations regarding the institution's exit from RALs. Although the examiners in the field did not agree with lowering the ratings of the two institutions, the FDIC did not document these disagreements in one instance, and only partially documented the disagreement in another, in contravention of its policy and a recommendation in a prior OIG report.

The absence of significant examination-based evidence of harm caused by RAL programs could have caused FDIC management to reconsider its initial assessment that these programs posed significant risk to the institutions offering them. However, lack of such evidence did not change the FDIC's supervisory approach. The FDIC's actions also ultimately resulted in large insurance assessment increases, reputational damage to the banks, as well as litigation and other costs for the banks that tried to remain in the RAL business.

The Washington Office also used a cursory analysis of underwriting plans that two banks submitted to show their mitigation of perceived risk to reject those plans. In fact, when the initial review suggested these underwriting plans could effectively mitigate certain risks, the Washington Office narrowed and

[3] The FDIC's current and historical policy is that it will not criticize, discourage, or prohibit banks that have appropriate controls in place from doing business with customers who are operating consistent with federal and state law. The FDIC applies this policy to services offered to bank customers, i.e., depositors or borrowers. Because RALs are offered through EROs and are third-party relationships, the FDIC does not believe this policy applies.

repeated its request to solicit a different outcome. It appears that the decision to reject the plans had been made before the review was complete. The alleged insufficiency of the underwriting plans also formed the basis for an enforcement action against one of the banks.

While the FDIC's Legal Division believed the pursuit of an enforcement remedy against the banks presented "high litigation risk," the FDIC chose to pursue such remedies. Members of the Board, including the then-Chairman of the Case Review Committee, were involved in drafting the language of a proposed enforcement order and in advising management on the development of supervisory support for the enforcement case. The FDIC also attempted to strengthen its case by pursuing a compliance-based rationale. To that end, in early 2011 the FDIC employed extraordinary examination resources in an attempt to identify compliance violations that would require the bank to exit RALs. This examination effort, in the form of a "horizontal review," involved deploying an unprecedented 400 examiners to examine 250 tax preparers throughout the country and the remaining bank offering RALs. The horizontal review was used as leverage in negotiations to get the final bank to exit RALs. Ultimately, the results of the horizontal review were used for little else.

The FDIC also employed what it termed "strong moral suasion" to persuade each of the banks to stop offering RALs. What began as persuasion degenerated into meetings and telephone calls where banks were abusively threatened by an FDIC attorney. In one instance, non-public supervisory information was disclosed about one bank to another as a ploy to undercut the latter's negotiating position to continue its RAL program.

When one institution questioned the FDIC's tactics and behavior of its personnel in a letter to then-Chairman Bair and the other FDIC Board members, the then-Chairman asked FDIC management to look into the complaint. FDIC management looked into the complaint but did not accurately and fully describe the abusive behavior. Nevertheless, the behavior was widely known internally and, in effect, condoned. Other complaints from the banks languished and ultimately were not addressed or investigated independently. Ratings appeals that included these complaints were not considered because they were voided by the FDIC's filing of formal enforcement actions. These complaints were eventually subsumed by settlement processes that, in the case of one bank, appeared to trade improved ratings and the right to purchase failing institutions for an agreement to exit RALs permanently.

Conclusion and Matters for Consideration

The facts developed by this review strongly reinforce the concerns and issues raised in the OIG's earlier Audit. In our view, the FDIC must candidly consider its leadership practices, its process and procedures, and the conduct of multiple individuals who made and implemented the decision to require banks to exit RALs. While we acknowledge that the events described in our report surrounding RALs involved only three of the FDIC's many supervised institutions, the severity of the events warrants such consideration. The FDIC needs to ask how the actions described in our report could unfold as they did, in light of the FDIC's stated core values of integrity, accountability, and fairness. Further, the Corporation must address how it can avoid similar occurrences in the future.

In December 2015, in response to concerns raised in the Audit, the FDIC removed the term "moral suasion" from its guidance. We appreciate the central importance of informal discussions and persuasion to the supervisory process; however, we believe more needs to be done to subject the use of moral suasion, and its equivalents, to meaningful scrutiny and oversight, and to create equitable remedies for institutions should they be subject to abusive treatment.

Because our work is in the nature of a review, and not an audit conducted in accordance with government auditing standards, we are not making formal recommendations. However, we request that the FDIC report to us, 60 days from the date of our final report, on the steps it will take to address the matters raised for its consideration.

The Corporation's Response

The OIG transmitted a draft copy of this report to the FDIC on January 21, 2016. We asked the Corporation to review the draft and identify any factual inaccuracies they believed existed in the report. We met with staff from the FDIC, on February 10, 2016, to consider whether any factual clarifications were appropriate, reviewed the documentation they provided, and subsequently made some clarifications to the report. The Corporation also requested that we include its response to our report herewith. We have provided the FDIC's full response at Appendix 9. The FDIC's response has not changed our overall view of the facts.

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Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel

I. Background

On December 17, 2014, the FDIC's Chairman, Martin **Gruenberg**[4] (Gruenberg), requested that the FDIC OIG conduct "a fact-finding review of the actions of FDIC staff" in Operation Choke Point. The Chairman's request was prompted by concerns raised by a Congressman, in a letter dated December 10, 2014, that asked that the role of five FDIC officials, and others as appropriate, be examined. Our office addressed the roles of the five individuals in our Audit Report No. AUD-15-008, dated September 2015, entitled *The FDIC's Role in Operation Choke Point and Supervisory Approach to Institutions that Conducted Business With Merchants Associated with High-Risk Activities* (the Audit).[5] In the Audit Report, we committed to conduct additional work on the role of FDIC staff with respect to the Corporation's supervisory approach to financial institutions that offered a credit product known as a refund anticipation loan. This *Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel* is the culmination of that work (the Inquiry). We have determined, that two of the five FDIC officials referenced by the Congressman (Mark Pearce (Pearce), Director, Division of Depositor and Consumer Protection (DCP), and M. Anthony Lowe (Lowe), Chicago Regional Director), as well as others, played roles in this area. Their roles are described throughout this report.

A. What is a Refund Anticipation Loan?

A refund anticipation loan (RAL) is a particular type of loan product, typically brokered by a national or local tax preparation company in conjunction with the filing of a taxpayer's income tax return. As part of the RAL process, the tax preparer, sometimes referred to as an electronic refund originator (ERO), works in cooperation with a financial institution to advance the refund as a loan, minus tax preparation costs, other fees, and a finance charge. The taxpayer, in turn, provides authorization to the Internal Revenue Service (IRS) to send the refund directly to the institution to repay the loan. One benefit of RALs is that they allow taxpayers to receive cash quickly, often on the same day they file their returns. However, as discussed below, the FDIC believed that RALs also present safety and soundness and consumer protection concerns.

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[4] The names of the former and current Chairmen, Vice Chairman, Directors and their senior staff have been bolded where they appear for the reader's ease in navigating this Report. Equally, certain sections have been bolded with italics in order to highlight particularly relevant statements and points.

[5] This report can be found at www.fdicig.gov/reports15/15-008AUD.pdf.

B. Summary of RAL-Related Audit Findings

Our Audit included an observation on the FDIC's supervisory approach to financial institutions that offered RALs. The FDIC considered RALs to carry a significant degree of risk to financial institutions, including third-party, reputation, compliance, and legal risks. Of particular concern to the FDIC was whether an institution could ensure proper underwriting and compliance with consumer protection requirements, particularly when RALs were brokered by large numbers of third-party tax return preparers/EROs in conjunction with the filing of a taxpayer's income tax return. Although RALs were not on the high-risk list of merchant categories that was published in an informational article contained in the FDIC's summer 2011 edition of the *Supervisory Insights* Journal, together with certain FDIC supervisory guidance, about which some in Congress expressed concern, we observed that the FDIC's supervisory approach to institutions that offered this type of credit product involved circumstances that were similar to those that prompted the Congressional request to our office.

We identified three FDIC-supervised institutions that offered RALs during the time period reviewed in the Audit. They were [redacted], Certificate number [redacted], [redacted], Certificate number [redacted], and [redacted], Certificate number [redacted]. These institutions began offering RALs in 1987, 1988, and 2007, respectively. At various times from 2004 through 2009, FDIC examiners criticized the risk management practices pertaining to RALs at two of these institutions during Compliance and Safety and Soundness (S&S) examinations. In late 2009 and early 2010, the FDIC sent letters to all three institutions expressing concerns about RALs and requesting that the institutions submit plans for discontinuing this type of lending. In early 2011, after efforts to convince these institutions to discontinue offering RALs were unsuccessful and supervisory concerns remained, the tenor of the FDIC's supervisory approach became aggressive. As part of this approach, in January 2011, Pearce and then-Senior Deputy Director, Division of Risk Management Supervision (RMS), [redacted] proposed, and then-FDIC Chairman, Sheila **Bair** (Bair) approved, the highly unusual step of conducting a simultaneous, unannounced review of 250 EROs in 36 states involving approximately 400 FDIC examiners in order to develop the evidence needed to compel any institution who had not yet done so to stop offering RALs if they would not do so voluntarily. In another case, then-[redacted], used a confrontational approach to pressure [redacted]s Board to terminate its RAL offerings. By April 2012, all three institutions had stopped offering RALs.

The Congress, IRS, the Office of the Comptroller of the Currency (OCC), and consumer advocacy groups have all raised concerns about RALs. Specifically, the Military Lending Act limits annual percentage rates on certain loans offered to military service personnel, including RALs, to 36 percent. The IRS has expressed concern that RALs may provide tax preparers with financial incentives to take improper tax return positions to inappropriately inflate refund claims.

The OCC's February 2010 *Policy Statement on Tax Refund-Related Products* described supervisory expectations for national banks that offer RALs and related products, as well as the associated legal, compliance, consumer protection, reputation, and safety and soundness risks. Consumer advocacy groups also criticized RALs as predatory in nature, saying they are costly and frequently targeted to low-income taxpayers. Contributing to these concerns was the IRS's decision, effective as of the 2011 tax season, to discontinue providing tax preparers and financial institutions with the debt indicator (DI). The DI is an underwriting tool that provided notification to EROs and banks of the IRS's intention to offset a refund for debts including federally insured loans, delinquent child support and federal and state tax liens.

Senior FDIC officials in Washington, D.C., including former Chairman **Bair**, considered the safety and soundness and consumer protection risks associated with RALs to be unacceptable and took actions to prohibit this practice at FDIC-supervised institutions. The FDIC drafted a Financial Institution Letter policy statement in 2010 that defined the FDIC's supervisory concerns and expectations for institutions offering RALs. However, the policy statement was never finalized. Our Audit concluded that establishing such a policy would have been prudent to ensure that institutions understood the risks associated with RALs and provide transparent supervisory guidance and expectations for institutions already (or contemplating) offering RALs.

II. Methodology

In addition to work conducted specifically for this Inquiry, we reviewed the summaries of the 166 interviews[6] and other key documents, including emails, developed during the Audit. A judgmental review of the emails of three FDIC employees, [redacted], were also used as a starting point to understand the process followed by [redacted] staff to complete Compliance and S&S examinations of [redacted] and review of their RAL programs. Specifically, emails were retrieved from the FDIC's email system of record, known as the "Enterprise Vault." The Enterprise Vault search results for Lowe and [redacted] requested during the Audit, that had included the terms "RAL" and "refund anticipation," served as the source for the initial review of their correspondence. Additional searches of the subject emails were conducted using the following terms: [redacted], [redacted], tax, and, tax refund anticipation loan (TRAL). Based on the information derived from the initial reviews, an Enterprise Vault search was requested for [redacted] the results of which were reviewed judgmentally for additional information and correspondence pertaining to the two banks. The search terms utilized in the search of [redacted] documents and correspondence were: RAL, [redacted], [redacted] tax, TRAL, and refund anticipation.

[6] As a part of the Audit, the FDIC OIG interviewed 103 current FDIC employees, three former FDIC employees, and 60 non-FDIC employees. For a complete list of all individuals interviewed as a part of the Audit, see Appendix 1.

We also judgmentally reviewed both sent and received emails from the Enterprise Vault for [redacted], Mark Pearce, and [redacted] for the period October 1, 2010 to March 14, 2011; Doreen Eberley, [redacted], and [redacted] for the period January 14, 2011 to March 14, 2011; [redacted] from August 1, 2010 through March 31, 2011; [redacted] and [redacted] for the period January 1, 2011 to March 31, 2011; and [redacted] and [redacted] for the period October 1, 2010 to December 31, 2010. Where gaps in information appeared due to only searching emails of particular individuals, we asked that a small number of additional emails be pulled to fill those gaps.

From the thousands of emails reviewed, we were able to compile a timeline of events leading up to the February 14, 2011 [redacted] Board meeting, that the Audit had identified as a key event, as well as identify discussions regarding the RAL programs at the three banks.

To gather more information, we conducted interviews of examination personnel in the field, management, senior management, and two Board members.[7] OIG staff interviewed a total of 25 people as a part of this Inquiry. Nineteen held current positions with the FDIC, four were former employees, and one was a State official. Two legal staff were interviewed jointly, two Division of Resolutions and Receiverships (DRR) staff were interviewed jointly, and one [redacted], was interviewed twice (the second time at his request). Twelve of the individuals interviewed were field or regional office examiners or supervisors directly or indirectly involved in examinations of either [redacted]. Four interviewees were legal counsel, two were DRR personnel, one was a former advisor to Chairman **Bair**, and three were executives in the Washington Office (WO) during the events in question. We also interviewed Chairman Martin **Gruenberg** and [redacted]. The complete list of interviewees and their titles is at Appendix 1 as is a list of the names and most recent position titles of all others referenced in this report.

To gain an understanding of the supervisory concerns relating to RALs, we reviewed S&S and Compliance examination information for [redacted] primarily for the years 2006 through 2012. For examination dates and ratings, see Appendix 2. These examinations were obtained from SOURCE, DCP's system of record for all Compliance and Community Reinvestment Act examination activities; ViSION, a web-based system used to track and document reports on financial institution supervision and enforcement actions; and RADD, RMS's system of record for all final S&S examinations and bank correspondence. The correspondence file within RADD was reviewed for each aforementioned bank to determine how the FDIC communicated concerns to the bank, and how the bank responded. SOURCE and ViSION were used to retrieve older S&S and Compliance examinations, and to determine the completion dates for those S&S and Compliance examinations. This information was used to

[7] Former Chairman **Bair** was interviewed by our office during the Audit and the topic of RALs was discussed with her at that time. Therefore, she was not re-interviewed as a part of this Inquiry.

determine the approaches taken during the examinations, their results, and where there was an impact on S&S examinations based on Compliance examinations.

Additionally, we reviewed formal and informal legal enforcement actions taken against [redacted] and [redacted]. These actions are defined in Appendix 3. This review included recommendation memoranda to the FDIC's Case Review Committee,[8] Case Review Committee minutes and packages, as well as draft and final versions of court filings and agreements between the banks and the FDIC.

We also reviewed a paper file of handwritten notes and other documents kept by now-retired [redacted].[9] This file dealt primarily with [redacted] but contained references to [redacted], and the FDIC's RAL strategy more generally.

Key documents have been compiled and indexed, and are provided with this report.

III. Consumer Group Complaints and the Formation of a Joint Examination Team

On February 5, 2008, then-Chairman **Bair** received a letter dated January 29, 2008 from consumer groups including: California Reinvestment Coalition, Community Reinvestment Association of North Carolina, Neighborhood Economic Development Advocacy Project, Woodstock Institute, National Consumer Law Center, and Consumer Federation of America. The letter asked the FDIC to examine and take enforcement action against [redacted] regarding its RAL program. Among other issues, the consumer groups pointed to [redacted] being one of the most expensive RAL providers. Then, on February 25, 2008, **Bair** posed a question to her staff. ***"Why are we allowing these RALs?"***[10] On February 29, 2008, [redacted], [redacted], emailed [redacted] and others that "[t]he question essentially was why examiners do not criticize [redacted]'s RAL loan program and I passed it along to [redacted] and [redacted] the other day… to let them know the Chairman is asking and will probably ask them directly…"

[8] The Case Review Committee is designed to be a "fair and independent high-level body overseeing the initiation of administrative enforcement actions within the jurisdiction of the Committee." FDIC Board Resolution Seal No. 072277 dated April 6, 2004.

[9] When interviewed as a part of this Inquiry, [redacted] explained that his handwritten notes did not contain direct quotes from individuals at the meetings he attended but were generally his paraphrasing of what was said by the individuals present. The list of initials in the upper left hand corner of his notes represented those who were present in the meeting, but may not be inclusive of all who attended a given meeting.

[10] Email from [redacted] to [redacted] and [redacted] copying [redacted] and [redacted] February 25, 2008.

[redacted],[11] [redacted] and [redacted], [redacted],[12] among others were tasked with getting the Chairman an answer.[13]

[redacted] and [redacted] suggested to [redacted] that a joint review of S&S and Compliance be conducted on [redacted].[14] On March 25, 2008, [redacted] reported to **Bair** that he was scheduling a meeting for her with the consumer groups that had sent the January 29, 2008 letter. He also informed her that "with [redacted] approval and under his direction, [redacted] has scheduled the inter-regional JET (Joint Examination Team) of S&S and Compliance examiners and supervisors to do an on-site visitation at the bank [[redacted]], to scrutinize the program, starting on March 31." [redacted] emailed [redacted] on March 24, 2008, stating that based on her receipt of a letter to **Bair** from community groups regarding [redacted]'s RAL program, [redacted] and [redacted] suggested a joint review for risk management and compliance. [redacted] advised them that she thought this was a good product for a JET review. She further informed [redacted] that she had conferred with [redacted], they had in fact agreed to begin the review on March 31, 2008, and that they had scheduled S&S and Compliance examinations for [redacted] in May 2008.[15] [redacted] also followed up with **Bair**, on April 8, 2008, to report that he and [redacted] would meet with [redacted], [redacted]'s [redacted], at [redacted] request, that afternoon about the RALs issue. On May 21, 2008, [redacted] reported to [redacted] and [redacted] copying [redacted], [redacted], that the "JET team finished most of their work on the RAL program and will be rolling the findings into the risk management (5/19[/08]) and compliance (5/27[/08]) exams [for [redacted]]."

IV. Barriers to Entry into the RAL Business

Around the same time, at least one financial institution was dissuaded from entering the RAL business. On June 23, 2008, [redacted], emailed [redacted], [redacted] and others, suggesting they hold a meeting with the [redacted] who was contemplating entering the RAL business. [redacted] also relayed a conversation he had had with the [redacted], "I told him [the President and CEO] that the **Chairman** has a heightened concern with this type of lending, and that there are other

[11] During the Audit, we made multiple attempts to contact [redacted] and she did not reply. Therefore, we di not make additional attempts to contact her as a part of this Inquiry.

[12] In September 2008 [redacted] in the Washington Office.

[13] Email from [redacted] to [redacted] and [redacted] copying [redacted] and [redacted] February 25, 2008.

[14] Email from [redacted] to [redacted] March 24, 2008.

[15] [redacted] forwarded the same information to [redacted] on March 26, 2008.

concerns that he should take into consideration, including compliance issues and third party risk." On July 3, 2008, the FDIC's [redacted] Regional Office (RO) personnel explained concerns about RALs to the [redacted] and told the same group at the FDIC that the bank had agreed that it would "not further pursue entrance into the RAL arena."

V. Response from the Chairman Regarding the FDIC's February 2009 Cease and Desist Order Against [redacted]

On February 20, 2009, [redacted] stipulated to a Cease and Desist Order. On February 27, 2009, the FDIC issued the Cease and Desist Order on [redacted] which required improvements to its compliance management system (CMS) and addressed certain violations identified in the May 8, 2008 S&S Examination. On March 9, 2009, by its terms, the Cease and Desist Order became effective.

On April 17, 2009, [redacted], [redacted], emailed **Bair** to follow up on her concerns and forwarded an explanation from [redacted], supporting an Equal Credit Opportunity Act violation against [redacted]. The violation was for dispersing RAL checks made out to both spouses, where collateral was based on a joint tax return, when only one spouse applied for the RAL. Then, on April 23, 2009, [redacted] wrote to [redacted] and [redacted] copying [redacted] and others, regarding the spousal signature violation cited for [redacted]'s RAL program. "The **Chairman** said that the violation did not make sense to her and she didn't think we should be spending time on spousal violations when we could be identifying real discrimination… She told him [[redacted] to tell us to reverse our positon on [redacted] Bank and that she didn't want to see anymore spousal violations." During her interview with our office as a part of this Inquiry, [redacted] told us that [redacted] had said that it appeared to the **Chairman** that this was the only thing being cited and she wanted to see violations such as loans denied or high pricing based on race or other types of discrimination.

On May 1, 2009, [redacted] emailed [redacted] "I just spoke with [redacted] and he wanted to confirm that we did not have [redacted] do the corrective action on the REG B[16] [spousal signature] violation as she [**Bair**] wanted it stopped. Also, he indicated generally that if the RAL business was legal [there's] not much we could do to stop it." [redacted] expressed to us in her interview with our office that she had told [redacted] that the examination process could not eliminate citations of spousal signature violations unless there was a policy change. She stated that management did not change the policy, but she told examiners that if they found such violations in the future, they needed to find something else as well.

[16] 12. C.F.R. Part 202 Equal Credit Opportunity (Regulation B).

VI. More Activities to Investigate RALs Generally

In July 2009, a Third-Party Working Group at the FDIC was reviewing RALs issues. One of the issues they considered was whether and how to use "mystery shoppers," or FDIC personnel or contractors posing as potential borrowers, to investigate the consumer experience at EROs.[17] On August 5, 2009, [redacted] announced the beginning of the development of a mystery shopper pilot program focusing on RAL providers and mortgage originators. [redacted], [redacted], became the point-person.[18] On August 10, 2009, [redacted] two FDIC economists, and three lawyers provided (via an email from [redacted]) [redacted] [redacted], and others with a RAL Recommendation Paper regarding the Mystery Shopper Pilot Program. They argued, "[m]ystery shopping is needed to determine whether consumers are being fully informed of their choices, whether the high fees and interest rates are clearly and accurately disclosed and whether other predatory products are sold in conjunction with RALs." Later the Recommendation Paper described RALs as "predatory and target[ed] [at] low income and unsophisticated consumers."

On August 26, 2009, DSC sought advice from the Legal Division (Legal) (copying [redacted] about how to make the Mystery Shopping Project "non-FOIAable/not subject to public disclosure in the future" among other things.[19] DSC also noted that ***"[t]he Chairman expressed an interest in keeping this non-public during the course of the project, but leaving open the option of making results public at the back end… We expect to use the info to support our exam function, and may use it to support enforcement actions."***[20]

To further develop the pilot, an FDIC Enforcement Counsel drafted a memorandum, dated September 21, 2009, to [redacted] and [redacted] detailing her undercover attendance at the 2009 Tax Forum in Dallas, Texas, held September 8-10, 2009. She focused on questioning exhibitors, including [redacted] and [redacted], in order to offer recommendations to the RALs mystery shoppers.

We did not find evidence that the FDIC moved forward with mystery shopping with respect to RALs. However, this reflects an additional avenue that the FDIC considered with respect to its approach to reviewing RAL programs.

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[17] Email from [redacted] to a broad group, subject: Third Party Arrangements, August 5, 2009.

[18] *Id*.

[19] Email from [redacted] to a group, subject: Legal Memoranda for Mystery Shopping Project, August 26, 2009.

[20] *Id*.

VII. The Letters to Exit RALs and Their Foundations

In late 2009, the FDIC contended that [redacted][21] had expanded its RAL program while operating under the 2009 Cease and Desist Order discussed above. In fact, while [redacted] had expanded the number of National EROs with whom it was affiliated (from [redacted] and Liberty Tax Services), it had simultaneously decreased the number of independent ERO providers with whom it worked, for a net decrease in EROs of 257 between the 2009 and 2010 tax seasons.[22] Nonetheless, this perceived expansion, and other factors described below, prompted Chicago Regional Director Lowe to send letters to the institution's Board, dated December 30 and 31, 2009, expressing continued concerns about the institution's RAL products and requesting a plan for discontinuing this type of lending. In separate letters, both dated February 3, 2010, Lowe notified the Boards of the two remaining institutions, [redacted] and [redacted], that RALs were unacceptable for the institutions and that plans should be developed for the expeditious exit of those lines of business. ***Notably, the FDIC had not identified any control weaknesses in [redacted]'s RAL program prior to sending the February 3, 2010 letter to exit***. The FDIC's letters to all three institutions were coordinated through the WO.

On November 9, 2009, the **Chairman** had again received a letter from various consumer groups concerning RAL fees at [redacted].[23] Once at the FDIC, the letter was distributed via email to a wide group including [redacted] and [redacted] In response, [redacted] referenced a meeting that would be held that afternoon with the **Chairman** on RALs.

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21 In 2009, [redacted]'s affiliate, [redacted], handled RAL origination and [redacted] purchased the loans on a daily basis. In 2008 and 2010, [redacted] handled originations directly.

22 Memorandum from [redacted] through [redacted] to [redacted] dated April 7, 2010; Undated Memorandum from [redacted] to [redacted] "The Bank makes the credible argument that the addition of 4200 ERO's affiliated with two large organizations while dropping a large number of independent ERO's actually had the effect of lowering the risk [to the bank]."

23 Earlier in 2009, then-Vice Chairman **Gruenberg** stated, in part, to the House Financial Services Committee:

> *The Social Security benefit investigation is only one example of institutions failing to provide the appropriate oversight of third party relationships. The risks of third party relationships have been known in the industry for some time, and the FDIC updated our guidance on third parties in June 2008. We have taken open bank enforcement actions in cases where the bank used third parties to implement refund anticipation loan programs, credit card programs, reward programs, overdraft protection programs, and subprime and/or predatory loan programs…*
>
> *As the current economic crisis continues, more and more institutions are suffering financial difficulties, which can lead them to look for higher returns and fee income wherever possible, including offering products that may not be advantageous for most consumers, or necessarily for the bank. Introduction of new products requires the FDIC's increased focus during examinations to assure that the institutions are not taking too much risk. When the FDIC discovers poorly devised products with the propensity to hurt consumers or provide opportunities for fraud, we pursue enforcement actions to revise the product or **eliminate it completely**.*

Statement of Martin J. Gruenberg, Vice Chairman, Federal Deposit Insurance Corporation on Federal and State Enforcement of Consumer and Investor Protection Laws before the Financial Services Committee, U.S. House of Representatives; 2128 Rayburn House Office Building, March 20, 2009.

When interviewed as a part of this Inquiry, Lowe told us that [redacted] called him on December 30, 2009, the same day the first letter of exit went to [redacted], and said he wanted to move quickly to get a letter to [redacted] telling the bank to exit its RAL program. Lowe stated that those in the WO felt that if they could get [redacted] out of RALs, the other banks would follow. Neither Lowe nor [redacted] were at work that day, but Lowe recalled talking, and exchanging emails, with [redacted], and [redacted] while they composed the letter that was ultimately sent to [redacted] that day. The verbiage included text from letters that had been sent to banks engaged in payday lending, as well as input from [redacted] regarding what [redacted] wanted in the message to [redacted].

In one email chain on December 30, 2009, [redacted] expressed concern about [redacted]'s potential expansion of its RAL business to Lowe and [redacted] "Don't we have problems with [redacted] such [that] this would be [in] contravention of our requirements on the company? …What I[s] [sic] going to be your reaction to [redacted], and when?" Lowe responded that the 2009 Cease and Desist Order for [redacted] "includes several provisions regarding audits and controls of third party risks, and requirements for [redacted] to conduct reviews of the lending activities of the entities who conduct RAL programs on their behalf. There is no limit on the volume, however."

Also on December 30, 2009, [redacted] emailed [redacted] and asked, ***"…what is our strategy with all banks involved in RAL lending? …Similar to the approach we took on payday lending, are we issuing a letter to all state non-member banks involved in RAL lending and advising them to terminate their relationships?"*** [redacted] replied later that day ***"I think we should be consistent and tell all our banks to get out of the business…"***

[redacted] reported, in another December 30, 2009 email to [redacted] copying Lowe and [redacted] that she had spoken with [redacted] that day about the need for the bank to exit the RAL business based on "continued concern over the utility provided by the product to consumers." She relayed the details of her discussion with him that she was continuing "to evaluate the appropriateness of this business line for the bank," "that the board should begin the process of planning its exit from the business line," and "that [FDIC] would be having additional discussions in the near future with the Board relating to an exit following the tax season." [redacted] stated that "[w]e plan to memorialize our conversation with a letter and request a plan to exit the business within 30 days." [redacted] forwarded the email to [redacted] and [redacted] the same day.

[redacted] also emailed [redacted] and [redacted] that day stating:

Anthony [Lowe] and [redacted] spoke with [redacted] [and] told him we appreciated the heads up on the expansion of [the] program but we had concerns that this was a [sic] prudent business line especially in light of problems with third party oversight, like payday lending [we] couldn't see the benefit as consumers could get their refunds for no costs within a short period so where [sic] the utility, the FDIC questions this business line for any

institution… [redacted] ***reminded him that this was similar to payday lending and the concerns with that… Hopefully this is really the exit and now we have to address others in that program.***

Lowe sent the letter of exit to [redacted] on December 30, 2009, memorializing the conversation and requesting a plan for exit from RALs, but not before alerting [redacted] that he would be doing so, to which [redacted] responded simply, "Good." Lowe wrote in the letter, "…we continue to opine that RALs are costly, and offer limited utility for consumers, as compared to traditional loan products. We also continue to have concerns regarding the bank's oversight of third party activities."

On December 31, 2009, Lowe sent a revised letter of exit to [redacted] changing the language of the letter of the previous day from "Therefore, we are requesting that the Board develop a plan to exit the RAL business. The exit should be accomplished following the end of the upcoming tax season" to "Therefore, we are requesting a meeting with management and representative board members… to discuss the future of the Bank's RAL program." Lowe told us the revision was prompted by a request from [redacted] to make the language "less harsh" until he could speak with the bank's Board about the matter.

During this same time frame, on December 24, 2009, [redacted], that operated [redacted], announced in an 8-K filing with the Securities and Exchange Commission (SEC) that the OCC had asked it to cease its tax refund business. On January 4, 2010, [redacted] requested information from [redacted] on how many FDIC banks were in the RALs business in response to a press article on [redacted]. [redacted] relayed the conversation she had with [redacted] to [redacted] and [redacted]

He asked if we were getting the banks out of the business. I told him that we had told one bank [[redacted]***] to get out and he asked the reasons we told them and I said these were not good products for banks, had little utility for the consumer and they had problems with oversight of third party activities. I said we had asked for [their] plan for their wind down from the business and would be having a similar conversation with other institutions involved in the product which I told him I believed were few. He was very pleased, asked the name of the bank and asked if I could find out how many banks were involved in RAL loans. So*** [redacted] ***you may get asked about it from the 6th floor.***[24]

That same day, Lowe suggested, via email to [redacted] and [redacted] drafting letters similar to what he sent to [redacted], in December 2009, for [redacted] and [redacted], but he wanted to ***"hold off on delivery until we have clear indication from the WO that this is the 'global' approach we are intending to pursue."*** His [redacted] responded, "What's the legal basis to request the others to exit?" [redacted] responded, "That's the trickier part… Our letter to

[24] "The 6th floor" is a common allusion used by FDIC staff for the Chairman's office.

[redacted] cites limited utility to consumers and cost, albeit we also have the third party aspect at [redacted]."

Shortly thereafter, Lowe forwarded, to [redacted] and others, an American Banker article about [redacted] working with Liberty Tax in offering RALs. [redacted] responded ***"I want them to stop."*** Lowe replied that [redacted] was sent a request to submit an exit plan by the end of February. [redacted] wrote separately to [redacted] copying [redacted] and Lowe, "[t]he purpose of this email is to provide details about our actions last week to require [redacted], KY to exit their RAL program." [redacted] replied to all, ***"they should not be doing this next year."*** [redacted] agreed and contemplated an amended order or a plan that would leverage the outstanding February 2009 [redacted] Cease and Desist Order. Lowe forwarded the email chain to [redacted] and [redacted] writing, "FYI on anticipated next steps, if [redacted] doesn't terminate the program."

The conversation continued the next day, January 5, 2010. [redacted] followed up by asking if [redacted] was expanding its RAL business. Lowe replied that overall volume was going to be the same or lower. [redacted] replied to Lowe and [redacted] copying [redacted] and [redacted] ***"[n]o new business, they are to exit RAL…"*** (ellipse original). Later, Lowe wrote to [redacted] copying [redacted] and [redacted] and stated, ***"I completely understand our position on RALs, and we will manage this situation towards a near term exit of the business."*** On March 10, 2010, Lowe sent a letter to [redacted] expressing concerns about its 'expansion' of its RAL program while under the February 2009 Cease and Desist Order that had found weaknesses in the bank's CMS. Lowe attached a revised proposed Consent Order.

Following the letter of exit to [redacted], the WO, including DSC and Legal, weighed in on content for similar letters to [redacted] and [redacted]. On January 8, 2010, [redacted] wrote to [redacted] and [redacted] seeking "points on requiring the banks to exit the RAL business." She offered the following for their review under the heading "The FDIC's position on RAL loans":

We believe that this product is unacceptable for FDIC supervised institutions because these loans are very costly to consumers, these loans offer limited utility to consumers, the bank relies on third parties acting on behalf of the bank which does not provide assurances that: customers are given accurate disclosures on the cost of the product, customers are not clearly provided options to RAL loans, the third party vendors are in full compliance with consumer protection laws and regulations.

On January 12, 2010, [redacted] forwarded edits made by two members of his staff in Legal to "The FDIC's position on RAL loans" language to [redacted] as she had requested.

As the language for the letters was being formulated, the American Banker published another article, "[redacted]," that quoted [redacted] on [redacted]. [redacted] wrote to Lowe, copying [redacted] and [redacted] about [redacted]

[redacted] comments. "I thought he clearly understood our expectations (exiting the business)." Lowe replied, ***"there were no ambiguities in our messages… We clearly stated they need to exit the business."*** [redacted] then forwarded [redacted] comment, but not Lowe's reply, to [redacted] "You should read this article. [redacted] doesn't think he is going to be ordered out of the business. Also it clearly says they will pick up some business from [redacted] [the OCC regulated bank that had recently exited the RAL business]."

With respect to the OCC order dealing with RALs at [redacted] [redacted] emailed [redacted] copying Lowe, [redacted] and others on February 3, 2010, that [redacted] wanted confirmation from the [redacted] Regional Office that the [redacted] Order has been amended and that "we have something in writing on the other two to get them out of the business at the end of this tax season." [redacted] also reported that [redacted], had "looped the **Chairman** in on this" and other emails in the chain reflect that **Gruenberg** was aware of the OCC's actions against [redacted].

Also on February 3, 2010, Lowe sent the letters to [redacted] and [redacted] asking them to develop a plan to exit their RAL businesses within 15 days. Lowe warned that supervisory and enforcement actions might be pursued against the institutions if their Boards failed to promptly submit plans for discontinuing their RAL programs. The following language, which incorporated suggestions from Legal, was included in the letters:

We find that RALs are costly, and offer limited utility for consumers, as compared to traditional loan products. They also carry a high degree of risk to an institution, including third party, reputational, compliance, and legal exposures. These risks may expose the bank to individual and class actions by borrowers and local regulatory authorities. Consequently, we find RALs unacceptable for the bank.

It is noteworthy that, as of the date of the letters, [redacted] had ***never*** been criticized by the FDIC in an S&S nor Compliance Report of Examination (ROE) for its RAL program. This reflects that the FDIC's concerns with RALs extended beyond how the banks were managing them to the nature of the product itself.[25]

[redacted] responded to the February 3, 2010, letter on February 9, 2010, and notified the FDIC that the bank's existing contract with its ERO partner would terminate on December 31, 2011; therefore, 2011 would be the final year that the bank would offer RALs. In his correspondence the CEO asked:

During your deliberations were there any ideas proposed on what changes could be made to the product that would address the agency's concerns and make the product acceptable? Do you know if the OCC has also concluded to prohibit institutions they regulate from offering RALs?

[25] [redacted] subsequently told us that sending the letters to the banks in late 2009 and early 2010 was premature.

Our hope is that the various regulatory authorities agree and will uniformly apply this prohibition.

The FDIC did not respond to [redacted] February 9, 2010, letter until eight months later. On July 14, 2010, [redacted] wrote to a number of people, including Lowe and [redacted] responding to a question about why the [redacted] had not responded in writing to the letter from [redacted] dated February 9, 2010. He wrote, "The RAL issue is a complex and sensitive matter with the Corporation and participants within our region. We have 3 RAL lenders in this region and we are coordinating our supervisory efforts of this product." He went on to say that he had spoken with the bank president twice since sending the letter but "[t]his is an ongoing matter and until certain issues are resolved, we are not in a position to respond in writing to the bank's inquiry."

Unlike [redacted], [redacted] and [redacted] did not agree to exit RALs at the time.

VIII. Questions from Congress

Two Senators alerted the FDIC of their constituents' concerns about banks being told to exit RALs. On February 3, 2010, Senator Mitch McConnell wrote to then-**Chairman Bair** attaching letters he received from [redacted], of [redacted] and [redacted], asking for "full and fair consideration of their request for a meeting prior to agency action in eliminating RALs." Then on February 10, 2010, [redacted] was notified about questions from Senator Richard Lugar's office regarding a constituent complaint that "[t]he FDIC is issuing notices to banks involved in offering tax-related products requiring them to close such divisions. FDIC has no authority to do this in the manner they currently are." The constituent was a [redacted] employee.

On March 12, 2010, [redacted], responded by letter to Senator Lugar. "The FDIC is committed to ensuring the financial institutions we supervise treat consumers fairly, comply with consumer protection laws and regulations, and operate in a safe-and-sound manner. It is extremely difficult to offer RALs in a manner that satisfies these requirements." **Bair** sent the same letter, on March 29, 2010, to Senator McConnell in response to his letter.

IX. The Office of the Comptroller of the Currency Issues RAL Guidance and the FDIC Considers RAL Guidance of Its Own

On February 18, 2010, the OCC issued guidance for national banks providing tax refund related products, including RALs.[26] The guidance outlines S&S and consumer protection measures banks should follow. Those measures include:

- *ensuring that the bank's board of directors maintains sound risk management policies, procedures, and practices to oversee all tax refund-related products.*
- *implementing effective internal controls and review standards for advertising and solicitations.*
- *providing appropriate disclosures that explain material aspects of the products to consumers.*
- *implementing appropriate due diligence and adequate procedures to ensure that tax refund-related products provided by third parties comply with applicable guidance.*
- *ensuring that Bank Secrecy Act (BSA) compliance risk management systems cover tax refund-related products.*
- *providing training programs (including certification processes) that address regulatory requirements, internal policies and procedures, and responsibilities for maintaining an effective compliance program.*
- *maintaining adequate capital and liquidity levels.*
- *developing timely and accurate management information systems (MIS) for tax refund-related products.*
- *ensuring the bank's compliance with all applicable laws and regulations, including those involving consumer protection.*

On the same day the guidance was issued, Lowe wrote to [redacted] and [redacted] copying [redacted] and others, that the [redacted] "conducted an analysis of the OCC's newly issued guidance, in relation to [redacted]'s RAL program… she opines they appear to be in compliance with most sections." Lowe told us that he was in the WO at a management meeting that day and during a break he spoke with [redacted] about the EIC's conclusion and [redacted] responded **"this doesn't change anything."** Then on February 22, 2010, [redacted]'s [redacted] wrote to [redacted] claiming that [redacted] already complied with "virtually all of these stringent guidelines…" that the OCC had recently issued related to RALs. Lowe told us that he agreed that [redacted] was in compliance with the OCC guidance on RALs.

[26] OCC Bulletin 2010-7 "Tax Refund Anticipation Loans." (Now rescinded and replaced, as of August 4, 2015, by OCC Bulletin 2015-36 "Tax Refund-Related Products")

In light of the OCC's issuance of guidance, the FDIC began to discuss potential RALs guidance of its own in the form of a Financial Institution Letter (FIL). On March 17, 2010, [redacted] wrote to [redacted] and others copying [redacted] – ***"In reviewing our draft RAL FIL… the Chairman has asked the following questions: What does ours accomplish beyond what is already out there? Will this impact [redacted]? Why did we decide to be less prescriptive [than the OCC]?"*** [redacted] scheduled a meeting for that day and told [redacted] *et. al*. that they needed to respond in writing that day as well. [redacted] replied that he did not know if the FDIC had the authority to be more prescriptive in the FIL "but we can certainly say for xyz reasons, we do not want our banks in RAL lending."

On March 19, 2010, [redacted], wrote to **Bair**, copying [redacted] and [redacted] comparing the FDIC's draft FIL on RALs to a policy statement put out by the Conference of State Bank Supervisors (CSBS), that opposed loans made against the amount of a consumer's anticipated income tax refund, and the OCC's guidance. He stated:

If we issue this FIL we would be the first federal supervisor to explicitly discourage banks from offering this product. *I believe our document would carry more weight with state non-member banks coming from their federal supervisor. In comparison to the CSBS document, which is a broad statement of view, I think the FDIC's draft carries a clearer sense of the specific concerns and that there could be actionable consequences if a bank offered this product.*

[redacted] went on to relay that ***"Marty [Gruenberg] thought it was a strong document but stated that his instinct was to wait to issue a document like this until we had taken strong specific action with one or more of our RAL lenders. He said he believes these lenders are recalcitrant and would ignore the FIL."*** No FIL on RALs was issued at this time.

When interviewed, as a part of this Inquiry, **Gruenberg** did not recall the draft FIL.

The idea for a RAL FIL resurfaced in 2011. Specifically, on January 31, 2011, [redacted] emailed a draft FIL entitled "Refund Anticipation Loans Policy Statement" to Pearce and [redacted] In part the draft read, ***"[t]he FDIC believes that it is not responsible lending to extend high-cost, short-term credit to consumers through products that provide limited value, such as refund anticipation loans (RALs)."*** And, "[w]hen unsafe or unsound practices or violations of law are found, the FDIC will take strong supervisory action, including requiring institutions to exit the business when appropriate." In his email, [redacted] wrote "…it's worth considering whether we should issue a RAL FIL in conjunction with any public statement we would make about our three RAL banks agreeing to end their RAL businesses. ***A FIL would serve as notice to our supervised institutions that we have significant risk concerns about banks offering RAL loans in the future."*** Pearce responded, "[l]et's keep this in mind. I want to see if we can achieve a resolution with [redacted] in the next month or two, then follow-up with something like this in the May time frame before institutions get going on next year's products." Ultimately, no FIL on RALs was ever issued by the FDIC.

X. [redacted] Response to the OCC's RAL Guidance

In response to a telephonic request made of [redacted] by [redacted] on October 21, 2010, and in light of the OCC's RAL guidance, the bank's CEO wrote a letter, dated October 28, 2010, to the FDIC. [redacted] had requested information regarding the number of EROs with whom [redacted] was engaged. The bank stated that [redacted] indicated that "it was the FDIC's desire that the bank not increase the number of EROs in 2011." She suggested [redacted] request permission to increase the number of EROs accepted into the 2011 RAL program or the volume of RAL funding in 2011 beyond 2010 levels, despite [redacted] not being under an order or engaging in an illegal practice. The CEO stated that [redacted]ey expected the number of EROs doing business with the bank and the volume of RALs to increase. In the prior year, the maximum RAL amount was $7,000; however, [redacted] proposed lowering the maximum RAL amount to about $1,800 in 2011. The bank stated that the decreased loan limit would result in little change to the volume of funding related to RALs.

Finally, the CEO stated:

Much has changed since I wrote to you on February 9, 2010 indicating that 2011 would be the final year we would offer RALs. On February 18, 2010 the Office of the Comptroller of the Currency issued guidance on consumer protection and safety and soundness for tax refund anticipation loans. Subsequent to their announcement, we anticipated that the FDIC might soon respond to our February 9, 2010 letter providing similar guidance. [redacted] *commented during our call that the agency is continuing to evaluate if RAL lending is appropriate.*

Considering the turn of events since my last letter, it is our desire to continue offering RALs in a safe, sound and responsible manner beyond the 2011 tax season.

XI. The Loss of the IRS Debt Indicator

On August 5, 2010, the IRS issued a press release that it would no longer be providing the DI beginning the first quarter of the 2011 tax season. The DI provided notification of the IRS's intention to offset a refund for debts including federally insured loans, delinquent child support and federal and state tax liens. The DI was one of many factors considered by the institutions that provided RALs when considering granting such a loan. The IRS had previously removed the DI during the years 1995-1999.

XII. OCC-Regulated [redacted] Exits RALs

Following the issuance of its RAL guidance, the OCC sent a Supervisory Letter, on October 19, 2010, to [redacted] requesting a plan from the bank to exit its RAL business. [redacted] submitted a plan to revamp its RAL program in light of the loss of the DI that would adhere to the OCC's guidance which the OCC rejected.[27] On November 24, 2010, the OCC sent a Supervisory Letter to [redacted] again requesting its plan to exit the RAL business. [redacted] submitted another plan to the OCC with an alternative plan to exit on December 14, 2010. On December 23, 2010, the OCC approved the alternative exit plan.

When interviewed as a part of this Inquiry, [redacted] who sat on the Case Review Committee with [redacted] and interacted with **Gruenberg**, stated that ***once the OCC convinced*** [redacted] ***to get out of the RAL business by declaring the bank's plan unacceptable, Gruenberg and*** [redacted] ***were "on a mission" to get the FDIC banks out of the program from a consumer protection standpoint. He relayed that it was an ongoing theme with them to be involved in the day-to-day activities on the supervision side of the FDIC and that they were generally directing supervision on this and other issues.*** **Bair** also told our auditors during the Audit that she was concerned that the RAL business from [redacted] might matriculate to FDIC-supervised institutions.

According to [redacted], her supervisor, [redacted] posed the rhetorical question, on more than one occasion, "if such a large institution as [redacted] cannot do RAL lending in a safe and sound manner, how can three small FDIC banks do so?"

XIII. The FDIC's Review and Rejection of Bank Underwriting Plans Given the Loss of the Debt Indicator

Following the first Supervisory Letter from the OCC to [redacted] regarding RALs, and out of concern that [redacted] EROs might move their business to FDIC banks that had RAL programs, Lowe drafted a letter regarding elimination of the DI that would go to the three remaining FDIC banks still in the RAL business. ***On October 25, 2010, Lowe sent the draft letter from the RO to*** [redacted] ***and*** [redacted] ***copying*** [redacted] ***"to ensure no conflicts with WO plans."*** [redacted] ***instructed that it be handled consistently with the*** [redacted] ***Order and added, "[m]aybe I'll have something after Chmn's policy meeting tomorrow. Please call me then."*** Lowe then sent [redacted] draft language for a letter to [redacted], on October 29, 2010, and stated ***"[w]e tried to stay away from any specifics on the Order, pending decisions at the WO on our final direction in this regard.*** However, we think it is important, given that the [redacted] EROs are looking for a home, to get this

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[27] While letters [redacted] 2010-25, [redacted] [redacted]-[redacted] and [redacted] [redacted]-[redacted] do not explicitly reference OCC Bulletin [redacted], the DI is mentioned in OCC Bulleting [redacted] and the rationale for rejection of [redacted] submitted plans references the criteria outlined in OCC Bulletin [redacted].

correspondence out asap."[28] Ultimately, requests were made, of each of the three banks offering RALs, for underwriting plans that would compensate for the loss of the DI. The banks' plans and the FDIC's rejection of those plans are described below.

A. [redacted]'s Underwriting Plan

On December 7, 2010, [redacted] submitted a plan to strengthen its RAL underwriting following the loss of the DI in response to the FDIC's request that it do so.[29] The plan, which was approved by [redacted]'s Board on November 17, 2010, anticipated that, even without the DI, the loss rate for the upcoming 2011 tax season on RALs would be 2.5 percent or less. In order to mitigate risk, [redacted] would require that a borrower receive a refund of $2,000 or greater, the refund be sufficient to cover the RAL plus all other fees, no RAL would exceed $1,500 plus finance charges and fees, and the underwriting model would be adjusted, in a number of ways, including the use of a Lexis Nexis RiskView public records search tool to check for encumbrances on the refund.

Almost a month later on January 3, 2011, [redacted] emailed Lowe, copying [redacted] and [redacted] stating, in part, "[redacted] and I have arranged for a review of the plan that [redacted] submitted to address the elimination of the 'debt indicator.' Will you please forward the package of information to the [redacted] to the attention of [redacted]?" [redacted] forwarded [redacted]'s underwriting plan to [redacted]) later that day. [redacted] then sent it to a number of colleagues for their input. On January 5, 2011, two of his colleagues [redacted] and [redacted] responded.

[redacted] stated, "I haven't ever looked at a program like this so I haven't spent a lot of time previously thinking about the specific risks, but here are some thoughts…" With respect to credit risk he wrote, "[t]here is some general credit risk here although mitigated because the refund will be sent by the IRS and [the] bank will have control of the money… ***It looks like [the] IRS is no longer providing lien information in advance and [the] bank is substituting a Lexis Nexis search instead. This seems pretty reasonable to me***…" He concluded, "[m]y overall assessment: there is some credit risk but probably not the biggest concern. Focus should be directed toward compliance issues…"

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[28] On November 5, 2010, [redacted] emailed [redacted] and [redacted] advising them that the IRS had done away with the debt indicator in the past. [redacted] replied, "[t]hat is true. IRS has stated that when they eliminated it previously the number of RAL[s] declined tremendously. That is why is [sic] was eliminated this year as a way to put an end to RALs. IRS no longer supports the product because they can get returns back to taxpayers sooner than they had previously. This makes RAL unnecessary now." [redacted] later replied, "I know you can't control the directional shifts either. I just don't want to say anything in conversation with the banks which puts us in a bad position to move forward in whatever direction we ultimately go."

[29] It is noteworthy that the DI was just one of 80 factors that [redacted] considered when underwriting a RAL loan. *See* [redacted] handwritten notes from a December 3, 2010 internal FDIC meeting on [redacted], attended by Pearce, [redacted] and others.

[redacted] stated, “I am not very familiar with this product so I may not be able to provide much in the way of incite [sic].” With respect to credit risk he wrote,

Credit risk is more elevated this year since the IRS did away with lien disclosure to tax preparers. ***The Lexis Nexis search helps [to] compensate somewhat because that will catch liens on the public record, property liens, and credit bureau information****. However, the IRS lien notification was probably a much better source of information on notification of liens that could reduce outstanding tax refunds as it would have the most up-to-date information…* ***All in all though credit risk, while elevated, would still probably be manageable.***

On January 7, 2011, [redacted] forwarded the emails from both [redacted] and [redacted] to [redacted] copying [redacted] and others. [redacted] then forwarded the emails to [redacted] copying Lowe. When [redacted] forwarded [redacted] email he wrote, in part, ***“[a]ccording to statements [in*** [redacted] ***email] below, there appears to be no concern with the elimination of the debt indicator.”*** When [redacted] forwarded [redacted] email he wrote:

The below and the previous feedback seem to view the plan they reviewed as the only plan [redacted] ***operates its RAL program under. This of course, is not the case. As you are aware,*** [redacted] ***has an extensive operating plan for RALs and the plan forwarded to the SF region was only a portion which was to account for the elimination of the debt indicator. While I don’t feel the plan adequately addresses how it will operate going forward with elimination of the debt indicator, the feedback below and from the other email forwarded to you doesn’t seem to provide definitive weaknesses in*** [redacted] ***’s overall operation.***

When interviewed as a part of this Inquiry, [redacted] confirmed he never received any other information on [redacted]’s overall RAL underwriting program. He stated that he also never contacted the bank, [redacted] RO, or WO to obtain any additional information. [redacted] went on to say that he and his colleagues did not have enough information to do a “full blown” analysis of [redacted]’s RAL model. He also stated that with what they received from the [redacted] RO, they could only offer a limited perspective, not an analysis per se. He said that his examiners expressed frustration in working with the limited information provided from the [redacted] RO.

[redacted] sent the [redacted] email chain to [redacted] on January 7, 2011, and he responded:

The [redacted] *examiner[’s] task was to evaluate the proposed credit risk measurement tool. I don’t see that below [in the email chain]. Did they provide the analysis of the tool, or will they?*

From their description, they're not experts on RALs. *They need to be alert that the credit risk extends well beyond fraudulent tax returns, and for such matters the bank replied [sic] upon the 'Debt Indicator' that is no longer available. We have others working on the bank matters.*[30]

Also on January 7, 2011, [redacted] wrote to [redacted] copying [redacted] stating:

[redacted] *thanks for the prompt response. I appreciate the examiners providing an assessment of third-party and other risks; however, we have other people evaluating those areas.*

The key question I want our retail folks to look at is more narrow, i.e., whether the use of the Lexis/Nexis search provides an acceptable credit risk measurement tool, especially in comparison to the default [sic] indicator that was previously available to the bank. *In other words, does the bank's current underwriting proposal (as laid out in the half-page description in their plan) provide an acceptable means to determine the borrower's ability to repay?*

Despite the fact that both [redacted] and [redacted] had already provided their views on [redacted]'s planned use of the Lexis Nexis tool, on January 12, 2011, [redacted] provided a one-and-a-half page memorandum through [redacted], to [redacted] analyzing [redacted]'s plan. "After review of the information submitted by [redacted], it remains ***uncertain*** if the underwriting process appropriately addresses the variables [for unsecured credit scoring model]." [redacted] also explained that "[t]o address the absence of the IRS Debt Indicator, the Bank is substituting that tool with the use of LexisNexis. However, this is not a direct substitute for the Debt Indicator in assessing the borrower's repayment capacity. It takes a period of time for liens to become a public record or to be filed with the appropriate state and local jurisdictions." Therefore, he concluded that, "the new underwriting procedures do not fully mitigate the absence of the IRS Debt Indicator, and do not consider the majority of data needed to assess risk in an unsecured consumer loan portfolio."

When we interviewed [redacted], as a part of this Inquiry, at first he said he was not sure why his memorandum did not fully reflect the feedback he received from [redacted] and [redacted]. [redacted] admitted that his memorandum was one sided, showing only the bad and not the good of [redacted]'s plan and he stated that it definitely was not a balanced perspective. ***Later, when asked why he had not incorporated the feedback of his colleagues or provided a more balanced perspective he stated, "I knew what they [the WO] were looking for and they got what they wanted."***

[redacted] told us that, based on the memorandum, she recommended to [redacted] and [redacted] that the FDIC "instruct the bank [[redacted]] to cease its RAL program as soon as it is

30 It is unclear who the "others" are that [redacted] is referring to but subsequent reviews of [redacted]'s RALs underwriting model, by examiners and the FDIC's Quantitative Risk Analysis Section in the Division of Insurance and Research, reflected that the model adequately addressed the loss of the DI. See Sections XXV and XXX.

practical to do so."[31] [redacted] agreed and sought [redacted] assistance in drafting a letter to [redacted] to "exit RAL lending." However, on January 10, 2011, [redacted] emailed Pearce, copying [redacted], "[d]id you get a chance to find out what happened between the OCC and [redacted] and its RAL relationship with H & R Block? I remain interested in what the OCC used as its legal grounds to encourage [redacted] to terminate the contract on legal and safety and soundness reasons…" Pearce sent [redacted] the OCC's rejection letters of [redacted] plans to compensate for the loss of the DI later that day. [redacted] responded that "[redacted] and I will look the documents over and get back to you with any questions." Then, according to [redacted] handwritten notes from a meeting he had with [redacted] [redacted] and [redacted] about [redacted] on January 11, 2011, ***the day before*** [redacted] ***sent his memorandum, "Mark Pearce talked to*** [redacted]***.*** [redacted] ***wants us to send out a letter to*** [redacted] ***saying that we have found the [underwriting] plan/model is inadequate." He goes on, "***[redacted] ***sees the next step is [sic] a Notice [of Charges] or some opening to negotiate a phase out [of RALs]."*** In other words, the directive to send a letter to [redacted], finding its underwriting plan inadequate, occurred before the WO had received the final analysis from their credit experts determining the plan was inadequate.

At this time, [redacted] was the [redacted], and voting member, of the Case Review Committee (CRC). The CRC is designed to be a "fair and ***independent*** high-level body overseeing the initiation of administrative enforcement actions within the jurisdiction of the Committee."[32] Deputies/Special Assistants to the Board members, not designated as the CRC's Chairperson, also sit on the CRC.[33] At this time, they were [redacted] for **Bair** and [redacted], for **Gruenberg**. The membership, as prescribed at that time, also included the Deputy to the Director of the OCC and the Deputy to the Director of the Office of Thrift Supervision.[34] Finally, [redacted], was on the CRC in a non-voting capacity. [redacted] appears to have prompted the supervisory "support," in the form of a letter declaring [redacted] had an "inadequate" underwriting plan, for a Notice of Charges (NOC), a formal enforcement complaint filed with an Administrative Law Judge, that was ultimately reviewed by [redacted] in his capacity as [redacted]. See Section XXI for additional

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31 Email from [redacted] to [redacted] copying [redacted] [redacted] and [redacted] January 12, 2011. Notably, in the email, [redacted] describes an assessment of [redacted]'s "model" but, as described elsewhere, only plans, not full underwriting models, were requested and reviewed by the FDIC.

32 FDIC Board Resolution Seal No. 072277 dated April 6, 2004.

33 Id.

34 Id.

discussion of the NOC. This would seem to call into question the independence of [redacted] and the CRC process in this case.[35]

When asked, as a part of this Inquiry, about his notes from January 11, 2011 and [redacted]**’s** role in [redacted]’s supervision, [redacted] told us that it was not typical for [redacted] to be involved in supervision activities. [redacted] further stated that it was unusual for [redacted] to be as involved as he was in [redacted]’s case but that it was not beyond [redacted]**’s** responsibility as a [redacted] to get involved. [redacted] explained it this way to us: “[d]oes the [redacted] have the authority to tell Supervision to send out a letter? No.” However, [redacted] added that if the Chairman of the CRC says he wants you to do something, “you should probably do it or you should convince him why you should not do it.”

[redacted] said that when he was informed that [redacted] had told supervision staff to issue a letter to [redacted] indicating that its plan/model was inadequate, he assumed that [redacted] had the impression that some analysis had been done on the bank’s plan because [redacted]**y** would have been talking with [redacted] about the review of the plan. [redacted] told us that he did not believe that [redacted] would tell people to manufacture evidence.

On January 13, 2011, [redacted] wrote to [redacted] and [redacted], copying [redacted] (later forwarded to [redacted] and [redacted]) regarding the FDIC Examiner’s analysis of [redacted]’s plan to mitigate risks following the loss of the DI. ***“I am concerned about the litigation risk (and related FDIC reputational risk) of going forward with a Notice of Charges based on this analysis… if this matter were litigated we could well see a defense that included a comparison of how [redacted] is planning to underwrite these loans to underwriting parameters the FDIC has articulated or accepted elsewhere, e.g., the underwriting standards we articulated in the context of the Small-Dollar Loan Pilot program.” He goes on, “it is not obvious to me that the underwriting [redacted] is contemplating would fail to pass muster under the standards the FDIC has articulated for use in the Small-Dollar Loan Pilot.”*** [redacted] responded to [redacted], “[e]xaminers with expertise in consumer credit risk modeling have reviewed the material that

[35] In response to this concern, the FDIC has told our office that the “notion of CRC ‘independence’ pertains to the *composition* of the Committee. Prior to 2004, the CRC consisted of 7 voting members, one of whom was a Division Director. The 2004 amendments removed the Division Director so the committee’s voting members were comprised exclusively of the Corporation’s Board members or their deputies (an internal director and one deputy/special assistant for each remaining Board member). We believe that the reconstitution of the CRC and introduction of the term “independent” in the 2004 resolution was not meant to banish Board members from enforcement oversight… The CRC Chairperson is expected to take an active role in the enforcement process and ‘to meet regularly with senior DSC and Legal Division enforcement personnel to review enforcement activities and matters…’ *See Page 12 of CRC Guidelines adopted by the CRC on November 2, 2004*. Nor is there a prohibition on two Board members discussing the terms of a proposed consent order; this shows active involvement in regulatory oversight and managing the corporation.” While we agree that the independence requirement would not “banish” the CRC Chairman from an oversight role, the 2004 change in composition of the CRC could certainly be understood as a step to prevent those who were engaged in the supervisory process from ultimately reviewing a case that sprung from it. Here, [redacted] was both involved in the supervisory process and he reviewed the case in his capacity on the CRC.

[redacted] supplied about RAL underwriting… Given the negative findings, DSC plans to issue a letter to [redacted] instructing the bank to exit RAL lending… The examiner finding is significant, and if the bank does not remedy the situation we should anticipate receiving an [sic] recommendation to issue an 8(b) notice [of charges].”

Notwithstanding [redacted] response, and as discussed in detail in section XVI, the following day, [redacted] circulated the Legal Division's final “Pros and Cons” regarding potential enforcement claims against [redacted] to [redacted], [redacted], [redacted], [redacted], Pearce and [redacted]. Notably some of the “cons” listed for potential legal action against [redacted] included: (1) the premise of the demand letter and Notice of Charges would be that the bank's new underwriting model does not fully account for the lack of the DI, based on preliminary and prospective analysis of the bank's untested model; (2) that the bank's model had not been formally examined or otherwise reviewed for safety and soundness; (3) without a ROE, or detailed analysis, based on actual loan activity it would be difficult to present any evidence that underwriting loans without the DI is unsafe and unsound; (4) that the bank's underwriting model appeared to compare favorably to requirements the FDIC had put forth in its Small-Dollar Loan Pilot; (5) that the bank's RAL program had a historically low default rate; and (6) that when the DI was eliminated in the 1990s supervisory recollection was that no banks suffered significant losses and no enforcement action was taken.

On January 20, 2011, [redacted] wrote in an email to [redacted] that,

I understand that in your conversation with [redacted] and [redacted] this morning, we have to amend this letter to provide the bank with an opportunity to send us additional info (i.e., the model itself), if they choose to do so. I have reviewed the letter trying to fathom where we would place such an offer without undermining the whole point of the letter, which is the requirement that they send us a plan to cease the program-now.

On January 21, 2011, the letter [redacted] described was sent to [redacted] from [redacted]. It explained that the bank's plan to address the lack of the DI in RAL underwriting had been referred by Lowe to the WO, whereupon several FDIC retail credit experts reviewed the plan and found it insufficient. [redacted] wrote, “[a]s a result, you [[redacted]] have not established a sound basis for underwriting such products consistent with safe and sound banking practices.” Therefore, the FDIC requested that [redacted] either provide additional information to support its position by January 31, 2011, or a plan to exit its tax refund related loan products by February 4, 2011. The letter to [redacted] was forwarded to **Bair** by Doreen **Eberley** (Eberley), Acting Deputy to the Chairman. (**Bair** received it again from [redacted]**a** on January 22, 2011.)

During her interview with this office, [redacted] stated that the review team was made up of retail credit card experts out of the FDIC's [redacted] office, headed up by [redacted].[36] [redacted] said [redacted]'s DI plan was sent to the [redacted] office for evaluation because it is a credit card hub and [redacted] was experienced in credit data analytics. She believed that if [redacted]'s team did not visit [redacted], they were sent data by [redacted] to review and evaluate. As described above, [redacted], [redacted], and [redacted] did not speak with, nor receive any information from, [redacted]. When we discussed the short time frame for the review with [redacted], she was ultimately not certain what they did to analyze [redacted]'s plan. [redacted] ***stated that she concluded that*** [redacted]***'s plan was inadequate based on the*** [redacted] ***DI plan analysis.*** She confirmed to us that she was the one who asked for the analysis. She said that she signed the January 21, 2011, letter telling [redacted] that its debt indicator plan was inadequate. [redacted] stated that she would not have signed the letter if she had not believed in the analysis done by the [redacted] personnel. [redacted] said that their conclusion did not surprise her because, again, the OCC had determined that [redacted] could not continue RAL lending in a safe and sound manner so how could [redacted] do so? However, as described above, [redacted], [redacted], and [redacted] did not conclude that the bank could not continue to offer tax refund-related loan products in a safe and sound manner, yet [redacted] so states in her letter.

In light of the nature and timing of the above events, it appears that [redacted] and the WO were shaping the opinion that [redacted] provided and that [redacted] had directed that a letter be sent to [redacted] rejecting its RALs underwriting plan before [redacted] had provided his memorandum.

On January 25, 2011, CEO [redacted] wrote to [redacted],

This e-mail is to confirm my request of last night for additional time to respond to your letter… which invites [redacted]*… to submit additional information supporting our underwriting model for refund anticipation loans ('RALs') by January 31, 2011. Five business days to prepare a complete and thorough response is insufficient, and we therefore request additional time to respond. We note that we are in the middle of the tax season, and in a few weeks, we will have sufficient funding data to demonstrate that our underwriting model is indeed safe and sound…*

We would also like to discuss further the analysis of the retail credit experts you mentioned that led to the conclusion in your January 21 letter regarding the Bank's underwriting standards. We request that you provide specific information regarding their analysis so that we may specifically address their concerns in our response.

[redacted] responded to [redacted] on January 28, 2011, denying his request for an extension of time to submit additional information supporting [redacted]'s underwriting model. Despite CEO [redacted]'s request, [redacted] did not provide additional information or support regarding the FDIC's

[36] During [redacted] interview with our office, she mistakenly thought the review was headed by [redacted] but was provided documentation which refreshed her recollection that the review was headed by [redacted]

review of [redacted]'s underwriting plan. She stated, ***"that clarifying data [that*** [redacted] ***might submit] is far less important given the settlement discussions we're undertaking at this point."*** [redacted] was referencing a proposed written agreement between the FDIC and the bank that she and CEO [redacted] had been negotiating. The negotiation process is discussed later at Section XVII.

Nevertheless, [redacted] submitted additional information with respect to its RAL program, on January 31, 2011, without the benefit of the FDIC providing it any information as to what its experts found lacking in its original plan. [redacted], again, authored a memorandum to [redacted], dated February 2, 2011, after review of the supplemental information provided by [redacted]. In this memorandum he concluded that "[g]iven the uncertainty of the 2011 financial projections, it is not possible to determine if the Bank can absorb higher RAL loss ratios and if the RAL product is viable."

Absence of an effective underwriting plan from [redacted] was ultimately the primary basis for the FDIC's NOC against the bank. See Section XXI. Finally, when [redacted]'s model for the DI was reviewed by FDIC's Quantitative Risk Analysis Section, sometime around September 2011, they found that the absence of the DI and the use of the bank's "underwriting model" did not expose the bank to an abnormal risk of loss. In fact, the bank's default rate proved better than predicted at approximately [redacted] percent versus [redacted] percent. See Section XXX.

B. The FDIC's Intention to Reject [redacted]'s and [redacted]'s Underwriting Plans

Conversations about how to reply to [redacted]'s plan were taking place between the [redacted] RO and WO as well as in WO Legal. On January 21, 2011, a discussion about how the DI letters for [redacted] and [redacted] that would be similar to the one sent to [redacted] that day, occurred among Lowe, [redacted], and [redacted]. The FDIC prepared a form letter of rejection for the [redacted] and [redacted] RAL plans. On January 28, 2011, [redacted] wrote to [redacted] ***"[h]ere is the draft letter for the other two banks [*** [redacted] ***and*** [redacted]***]. It will need to be somewhat conformed to each bank based on what they gave us."*** [redacted], and [redacted], all suggested getting details from the RO before sending out the letters. [redacted] wanted to ensure that the plans submitted by the banks had actually been reviewed.

C. [redacted]'s Underwriting Plan

On November 1, 2010, [redacted] sent the letter to [redacted] requesting that [redacted] provide a plan to strengthen its underwriting process for RALs in the absence of the DI. He alerted the bank that the FDIC had concluded the bank's May 15, 2009 Compliance Examination and that the results would lead to a Consent Order because:

…the Board has failed to exercise an appropriate level of oversight over the institution's nontraditional products that is commensurate with the heightened compliance, legal, financial and reputation risks associated with the bank's third-party relationships through which these products are offered. Furthermore, you have not established effective monitoring and auditing reviews that are sufficiently robust to assess the elevated risks associated with the nontraditional products. The Board has also failed to provide the necessary resources and expertise to manage and oversee the significant risks posed by the nontraditional products and the bank's reliance on third-party vendors. The Board's lack of oversight and weak procedures have potentially led to apparent significant violations… related to unfair and deceptive acts and practices…"

On November 15, 2010, [redacted] attorney responded to the FDIC's November 1, 2010 letter, addressing a number of issues, including the loss of the DI. He stated:

Throughout [redacted] 20-plus years of offering RALS, the DI periodically has been unavailable for various reasons. During these periods, [redacted] has effectively minimized the risk of non-payment even without access to the DI. For several reasons, [redacted] anticipates that, going forward, it will be able to continue to offer RALs in a safe and sound manner. [redacted] is currently in the process of finalizing its revisions to the RAL underwriting process for the upcoming tax season. However, the bank has already identified several significant changes that will strengthen the RAL underwriting process. [redacted] intends to offer a reduced dollar amount RAL at a reduced cost of $20 or less. Moreover, the bank will lend only to customers with a credit score of 650 or greater…

In fact, the RAL product that [redacted] intends to offer complies with the FDIC's recently developed small-dollar loan template, which FDIC devised to be a 'best practice illustration of a model for safe, affordable, and feasible small-dollar lending.' …[Including] a loan amount under $2500, an APR of 36% or less, a term of 90 or more days, low fees, and the lender's use of the applicant's credit report to determine loan amount and repayment ability…

[redacted] attorney went on to explain the benefit of the bank's RAL program for unbanked customers who "do not have checking accounts and therefore are unable to receive their tax refunds electronically from the IRS within 14 days." He stated,

…many unbanked customers who wait 6-8 weeks to receive a refund check in the mail may then incur check-cashing charges in excess of the cost of the RAL in order to have access to their refund. RALs provide these customers not only with immediate access to necessary funds, but also with access to professional tax preparers with no upfront fees or charges.

He concluded by requesting a meeting with the FDIC to discuss the bank's RALs underwriting plan. The FDIC did not formally respond to [redacted] letter but, as described later in this report, the FDIC did continue its efforts to get [redacted] to exit RALs.

D. [redacted] Underwriting Plan

On November 3, 2010, Lowe sent a letter to [redacted]'s Board asking them for a plan to strengthen the bank's underwriting of RALs in light of the loss of the DI. On November 17, 2010, the [redacted], sent Lowe the bank's plan to strengthen its RAL underwriting process in the absence of the DI and stated:

Some in the media, and many consumer groups, believe that the DI service provided by the IRS in 2010 was the exclusive criteria used in the underwriting of RALs. In a recent letter to the FDIC and the OCC, a consortium of consumer groups noted that 8.8% of the general population show a 'pending tax offset.' These groups go on to note in their joint letter that the absence of the DI would result in loan losses of 8% or worse, given the 8.8% level of pending tax offsets. The consumer groups worry that the RAL programs in the absence of a DI would be risky and destructive given a presumed high level of charged off loans.

These consumer groups appear to lack experience in RAL underwriting and may believe that the IRS's DI service was the sole tool in underwriting RALs. The DI service is not essential to the successful underwriting of RALs. In fact, tax year 2011 will not be the first time that RALs will be offered without the IRS's DI service. Most recently, the IRS removed this service from the period 1995 through 1999.

He further stated that, "it has not been the practice of [redacted] to rely solely on the IRS's DI service. In fact, the RAL criteria employed in the 2010 filing season consisted of over 120 different criteria, each of which had to be met in order for a RAL applicant to receive a RAL."

[redacted] also cited a past product that the bank underwrote, prior to receiving the DI information, that had a charge-off rate of less than [redacted] percent. With that product, the bank looked to "attributes of the tax return, the taxpayer prior year tax return history, and data from third-party services to determine the existence of government debt."

The bank also performed an analysis to prepare for the 2011 tax season, reviewing applications received in the 2010 filing season. It used this data to determine what the charge-off rate would have been in 2010 without the DI. Without any additional credit-worthiness metrics or the DI in place, the bank estimated its loss rate would have been low, at [redacted] percent, on its 2010 RALs. The bank felt it could further decrease its loss rate to a range of [redacted] percent by implementing risk mitigating measures including, but not limited to, lowering the maximum loan amount from $7,000 to $1,800 and utilizing third-party services. A third party service that [redacted] proposed using was a CSC/Equifax tool originally developed and specifically marketed to RAL lenders in the mid-1990s as a tool to provide debt offset information the last time the IRS discontinued the DI. [redacted] stated that this proven tool would be further supplemented with a "credit decisioning product" available from LexisNexis called "RiskView DI," a product also designed to be a predictive tool indicating the likelihood of an IRS debt offset.

By comparison, a credit card program, in banks of similar peer group size,[37] had much higher net charge-off ratios than [redacted]'s RAL lending product. The table below presents comparison of the net charge-off rates of peer group credit card programs versus the charge-off rates of the RAL program supplied by [redacted].[38]

Year	[redacted] RAL Charge-Offs	Peer Group 3 Credit Card Net Charge-Offs
2007	[redacted]	[redacted]
2008	[redacted]	[redacted]
2009	[redacted]	[redacted]
2010	[redacted]	[redacted]

Source: Uniform Bank Performance Report, for The [redacted] Years 2007-2010, Pg. 9, [redacted]ey's RAL charge-offs were provided in analysis in a letter sent to the FDIC on November 17, 2010.

[redacted] reviewed the letter submitted by [redacted], outlining bank management's plan to mitigate increased risk due to the loss of the debt indicator. Among the risks a loan product poses to a financial institution, [redacted] analysis highlighted underwriting risk, concentration risk, legal/reputational risk, and regulatory risk. [redacted] identified the bank's concentration of RALs as a point of concern. He noted RAL loans made up [redacted] percent of the bank's total loans and [redacted] percent of its Tier 1 Capital as of September 30, 2010, and that a concentration of nearly [redacted] percent is not reasonable. While an unsecured loan portfolio of [redacted] percent represents a high concentration of the bank's capital, this concentration was subject to wide fluctuation. The bank's outstanding RAL portfolio balance would vary greatly due to the short-term nature of the lending product and the concentrations would, of course, peak at the height of the tax season. [redacted] noted that poor underwriting controls could lead to sizeable losses. He also concluded that the loss of the DI would likely increase the default risk.[39]

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37 Peer averages are used in this report to provide the reader with context. Peer averages are not used to support conclusions about CAMELS ratings, they simply provide the reader with a basis for comparison to other financial institutions of similar asset size.

38 We acknowledge that open-ended loan products like credit cards are dissimilar from RALs, however, the FDIC itself used retail credit card experts to determine the validity of the bank's plan to substitute other indicators to offset the lack of the DI and this analysis was offered by the bank.

39 Notably, several lines in the final paragraph of [redacted] memorandum were the same or similar to some of the language in [redacted] memorandum.

As described above, to mitigate the loss of the DI, management planned to lower the loan limit which would likely lower the concentration, or total asset size, of this portfolio. The bank would have needed to greatly increase its production volume of these loans to achieve the preceding years' loan levels with the lower loan limits. The bank did not state it had plans to aggressively market the product. The letter to the FDIC also indicated that the bank anticipated higher loss ratios and would fund the allowance for loan and lease loss account accordingly. This proactive measure required management to budget for higher losses from the lending program directly impacting the bank's income statement.

The letter from [redacted] indicated that the bank used 120 different criteria to evaluate the viability of each RAL. We did not identify subsequent requests by the FDIC for additional information to determine what these criteria were. It is not clear from [redacted] analysis whether he considered these criteria.

[redacted] did not suggest that the bank would be unable to minimize losses through its plan provided to the FDIC. He merely outlined the facts and stated that, ultimately, the bank and the FDIC were unable to know if the measures the bank planned to implement would mitigate the increased risk due to the loss of the DI.[40]

When we spoke with [redacted] as a part of this Inquiry, he told us that while [redacted]'s plan projected higher losses, controls were in place. He stated that he did not conclude that the bank's program was unacceptable nor that its RAL program constituted an undue risk to the bank. He went on to say that ***he in no way concluded that*** [redacted] ***could not offer RALs in a safe and sound manner. To the contrary, he stated that he believed what*** [redacted] ***proposed in its November 17, 2010 letter appeared to be reasonable.***

On February 3, 2011, Lowe sent correspondence to [redacted] stating that the bank needed to terminate its RAL program. Excerpts from the letter are outlined below.

…you have not established a sound basis for underwriting such products consistent with safe and sound banking practices. *Other defined weaknesses, relative to RAL lending, include:*

- *An absence of a formally approved written policy for this line of business;*
- *Insufficient monitoring or oversight of training for third party vendors; and,*
- *A limited scope audit review.*

[40] Per the FDIC Risk Management Manual of Examination Policies, "a forward-looking supervisory approach that identifies and seeks to correct objectionable conditions requires serious thought and a balanced response by examiners. Critical comments must be well supported and based on facts, logic, and prudent supervisory standards. Although examiners cannot predict future events, they should consider the likelihood that identified weaknesses will cause material problems in the future, and consider the severity of damage to an institution if conditions deteriorate."

If you believe there is a basis upon which we should reconsider this conclusion, you should submit information in that regard by February 9, 2011.

As discussed above, we have concluded that the* [redacted] *cannot continue to offer tax-refund related loan products in a safe and sound manner. *Therefore, please submit to us, by February 11, 2011, a plan for discontinuing this product which will provide for a prompt exit from the program. Failure to do so could result in the pursuit of supervisory and enforcement actions against the* [redacted]*, including enforcement actions under various subsections of 12 U.S.C. 1818.*

The outcome was of interest to the FDIC's top executives and the Chairman's office. On February 7, 2011, [redacted] emailed Lowe copying [redacted] and [redacted] asking for "…status of [redacted] and [redacted], including the dates that docs were sent to them. Need it asap for discussions at **Chmn's** Policy [meeting]." Lowe provided the information.

On February 9, 2011, with the continued pressure on banks offering RALs, [redacted] wrote to Lowe stating that the bank would discontinue offering RAL products "after the 2011 tax season, which ends April 21, 2011." [redacted] stated that he hoped this letter would "further evidence" the bank's responsiveness to each and every request made by the FDIC. Following this correspondence, [redacted] exited the RAL business as promised.

XIV. The Chairman Raises Questions about RALs and [redacted]

On August 4, 2010, the day before the IRS announced the end to the DI, there was a "[redacted]" scheduled by the **Chairman's** office. Required attendees included **Bair**, [redacted] had sent a letter, on July 2, 2010, to the FDIC's Office of the Ombudsman complaining about the delay by the FDIC in issuing [redacted]'s 2009 Compliance ROE. A copy of his letter was sent to **Bair**. Following the meeting, [redacted] circulated to [redacted] and others, copying **Bair**, [redacted] and [redacted], the **Chairman's** questions and requests from the meeting. They were as follows:

1. "What is our strategy regarding RALs – eliminate RAL or get the cost down?"
2. "What are the total fees and APR for the bank's RALs? Would like a break down."
3. "How much of their revenue comes from RAL?"
4. "What's the OCC doing? Do they have any banks that offer RALs? Copy of the policy on RAL"
5. "Does the Fed have any banks that offer RALs?"
6. "What happened at the 2009 exam? Why did it take so long? Status of the bidder list issue."

7. "Need detailed, point-by-point response letter to [redacted]'s letter."

Taking number seven above first, [redacted] emailed Lowe, copying [redacted], following the meeting with the **Chairman**. She stated:

We had the briefing with the Chairman today. She suggests that we prepare a point by point response to [redacted] ***'s letter to set the record straight.*** [redacted], [redacted]*, and I had a discussion on how to best to do that. One idea was since you were copied on the letter perhaps you should send your response to OO [Office of the Ombudsman] as well; however,* ***I think we will need to run it by the Chairman's office prior to sending it.*** *Please prepare your response.*

By August 10, 2010, Lowe had drafted a memorandum to [redacted] providing a point-by-point response to CEO [redacted]'s letter to the Ombudsman.

On August 11, 2010, Legal sent draft responses to questions and requests posed by the **Chairman** about RALs, which were reviewed by [redacted] and [redacted], to [redacted] and [redacted].

There were a number of points of contention between Legal and DSC with respect to how to answer these questions and requests. Most of the disagreement centered around numbers one and two above. [redacted] wrote to [redacted] "[w]e understand that in response to item #1 (RAL strategy), DSC intends to indicate that its overall strategy is to end RAL programs at our banks. We wanted to confirm that this is different from our agreed upon strategy for [redacted]. Is it your understanding that for [redacted], both DSC and Legal agreed that we should take a global settlement approach that limits and caps [redacted]'s RAL program, but does not require them to exit the business?" [redacted] had written earlier that day to [redacted] and others, "Thanks for the feedback. I understand your edits to #1; however, ***DSC senior management's goal would be to get them out of the business.*** I will have to get approval up the line before I submit." Legal and DSC also disagreed about how to express the total APR and fees charged by the bank as well as the total number of transactions.

On August 16, 2010, [redacted] provided Legal's response to the **Chairman's** items numbered two and four above. It was determined that [redacted] appeared to be in compliance with all but one of the factors, reviewed by examiners, listed in the February 2010 OCC Guidance on RALs. Legal also compared APR and fees charged by [redacted] to FDIC's FIL on Affordable Small-Dollar Loan Products, FIL-50-2007. "[redacted]'s 2010 RAL program has an APR of approximately 24 percent. The FIL does not set specific caps on interest rates but does encourage small dollar credit with APRs of less than 36 percent and low fees." [redacted]'s fee was $30.00. This analysis was forwarded to **Bair** on September 22, 2010.

On September 3, 2010, [redacted] sent [redacted] responses to the **Chairman's** questions and requests but did not directly answer question one. On September 14, 2010, [redacted] emailed [redacted], [redacted], [redacted], and others, copying [redacted], that "[w]e have sent all the information the Chairman requested to [redacted].” This response, along with a point-by-point response to CEO [redacted]’s letter to the Ombudsman, was forwarded to **Bair** by [redacted] on September 22, 2010.

XV. Downward Adjustments to Supervisory Ratings

The FDIC is the primary federal supervisor for all state non-member banks. For these institutions, the FDIC performs risk management (safety and soundness or S&S), Trust, Bank Secrecy Act, Anti-Money Laundering, Information Technology, Compliance, and Community Reinvestment Act (CRA) examinations in cooperation with state banking regulators. Most state banking agencies participate in an examination program where State and FDIC examiners perform examinations (depending on asset size and risk) on an alternating basis. Larger banks are usually evaluated during a joint examination by State and FDIC examiners.

The outcomes of the FDIC’s S&S examinations are expressed in both component and composite ratings. The component ratings are known as “CAMELS.” CAMELS stands for Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk. Each component, and an overall composite rating, is assigned a rating of “[redacted]” through “[redacted]”, with “[redacted]” representing the least regulatory concern and “[redacted]” representing the greatest concern. These ratings have consequences for the subject financial institutions. Some of the applicable consequences for the lower composite and CRA ratings received by [redacted] and [redacted], as discussed in depth below, included, higher assessments of insurance premiums paid by the banks to the FDIC; litigation costs associated with ratings appeals, consent order negotiations, and notice of charges; civil money penalties; loss of ability to expand by opening new branches or purchasing failed institutions; and, ultimately, the loss of revenue generated from the product that they were forced to abandon in order to receive ratings upgrades. Given the severity of some of these consequences, the transparency of the ratings process is key.

To that end, and prior and unrelated to this Inquiry, the OIG conducted an audit entitled *FDIC’s Controls Over the CAMELS Rating Review Process*, issued August 2008 (AUD-08-014). The OIG recommended that the DSC revise the Case Manager Procedures Manual to require that changes made to EIC-proposed CAMELS ratings in any draft ROE be centrally managed by DSC, including tracking, monitoring, and maintaining the documented justification and approval for changes.

DSC generally agreed with the OIG’s findings, but offered alternative corrective actions, including formalizing the guidance to staff on the required method for documenting unresolved differences related to final CAMELS ratings and developing a method to track those instances. Depending on the ultimate content of the DSC guidance, the OIG agreed that DSC’s actions could substantially meet the intent of our recommendation to help ensure process integrity and transparency. Additionally, the OIG believed that there was value in maintaining a record when there were changes to an EIC-proposed rating, even when the EIC did not ultimately contest that change. The OIG also suggested that DSC consider requiring a record of differences in CAMELS ratings between EICs and management during the course of formalizing its guidance in this area.

DSC issued a memorandum entitled "Documentation of CAMELS Rating Changes During the Report Review Process for Risk Management Reports of Examination," on July 22, 2009. DSC developed a feature within its system of record for examinations, known as ViSION, to address the recommendation. ViSION's Supervisory Tracking and Reporting module captures any CAMELS rating change occurring during the review process where the EIC did not concur. For any such change, the reviewer will answer the "Ratings Difference with EIC" question with a "Yes," which triggers a new "Ratings Comment" tab to become available for input. The reviewer then provides a succinct factual justification in this tab to include the following:

- The specific preliminary rating(s) changed;
- Reason(s) for the change;
- Date the change(s) were discussed with the EIC; and
- Acknowledgement of EIC disagreement.

The Regional Director, or designee, is responsible for ensuring the accuracy of the data input into these data fields. The guidance also stated that staff should discontinue the prior practice of documenting rating changes in the ROE and its Confidential Supervisory Section. Upon issuing the new guidance, no updates or changes were made to the "Case Manager Procedures Manual." Section 3.1-1 of that manual still reads:

If a CAMELS component or composite rating change is considered, concurrence of the EIC should be sought. If the EIC concurs with the change, the new rating should be reflected throughout the report as well as on the Summary Analysis of Examination Report (SAER). If the EIC does not agree to change the originally assigned rating, Case Managers (with approval of the Regional Director or designee) will draft a memorandum to the file to support the rating change, with copies to the EIC and Field Supervisor. The new rating should then be reflected throughout the report and on the SAER. Bank management should be informed of the change prior to transmitting the ROE to the bank.

As a part of this Inquiry, and since the inception of this guidance, we identified two instances where the CAMELS composite ratings were changed from the EIC's proposed rating. We reviewed the 2010 S&S ROEs for [redacted] (August 30, 2010) and [redacted] (October 25, 2010).[41] Both of these institutions were supervised by the FDIC's [redacted] RO, led by Regional Director Lowe. As part of this Inquiry, we interviewed the EICs for the [redacted] and [redacted] S&S examinations, [redacted] and [redacted], respectively. Each told

[41] Dates of ROEs reflect the date the examination began.

us that their original ratings were lowered by management and that they disagreed with the lower ratings. We found ViSION reflected that [redacted], [redacted], did not agree with the CAMELS ratings changes, although ViSION did not contain all required information prescribed by the aforementioned memorandum on documentation of ratings changes. For [redacted], however, there was no documentation noting [redacted]'s disagreement with the CAMELS changes. Equally, neither the [redacted] nor [redacted] ROEs reflected the changes nor did we uncover memoranda supporting the ratings changes as required by the Case Manager Procedures Manual.

For the August 30, 2010 [redacted] S&S ROE, [redacted]'s disagreement was noted in ViSION by now-retired [redacted]. On January 25, 2011, [redacted] wrote to [redacted], the [redacted], and explained that if an examiner disagrees with the ultimate rating for a bank examination, as the EIC did with [redacted], a comment, so stating, must be included in ViSION. [redacted] ***offered proposed language reflecting the EIC's disagreement with*** [redacted] ***'s ratings and asked "[i]s this innocuous enough?"*** The Ratings Comment section reads as follows:

The EIC originally submitted a proposed rating of 112112/2, and after considering the impact of the RAL program, and the serious, material, and continuing concerns identified in the recent Compliance exam, the bank's earnings and liquidity components were lowered to a 2, and the composite was lowered to a 3.[42]

As noted above, the guidance also requires the date the changes were discussed with the EIC, and that the acknowledgement of the EIC of his or her disagreement be entered into the system. [redacted] did not include those points of information within the Ratings Comments tab in ViSION for the August 30, 2010 [redacted] S&S ROE. During an interview with OIG staff, [redacted] ***stated that he agreed with*** [redacted] ***'s original ratings but made changes as directed by*** [redacted]. [redacted]***n stated he rarely made changes to examinations and the direction from*** [redacted] ***was also atypical.***

For the October 25, 2010 [redacted] S&S ROE, [redacted] had originally proposed a "[redacted]" composite rating with which his compliance examiner counterparts agreed.[43] When interviewed as a part of this Inquiry, his [redacted] acknowledged that he had authorized [redacted] to report the "[redacted]" rating to the bank, which [redacted] did. However, after comparing the pending [redacted] S&S ROE with the recent 2010 [redacted] S&S ROE, [redacted] determined that a "[redacted]" rating was likely more appropriate. Then, [redacted] directed [redacted] to change the composite rating to a "[redacted]" due to the issues identified in [redacted]'s May 15, 2009 Compliance

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[42] As discussed below, the State gave [redacted] a composite "[redacted]" at this S&S examination. On January 18, 2011, [redacted] wrote to [redacted] that the findings by the State were "substantially similar to our S&S Report except for the rating."

[43] Email from [redacted] to [redacted] [redacted] and [redacted] December 7, 2010.

ROE (completed on December 29, 2010),[44] and the potential risks with RALs.[45] This was also implied in a January 20, 2011 email from [redacted] to [redacted] and [redacted] where he stated, "we will need a major rewrite on [redacted]." ***It is important to note that at the time that examiners and first-line management proposed a composite "2" rating, they had full access to information from the ongoing [redacted] Compliance Examination, had conferred with examiners on the Compliance Examination, and were aware, as discussed below, of Lowe's instruction to staff to fully consider the finding therein.***

[redacted] told [redacted] that Lowe had made the decision to lower the rating to a "[redacted]" but [redacted] felt that these changes were also influenced at a higher level within the FDIC. [redacted] also directed [redacted] to identify additional risks and include language in the ROE to support the lower rating. [redacted] made the adjustments but, in hindsight, the composite "[redacted]" was in [redacted]'s words, "hard to swallow" and it appeared to him that the ROE was used to get [redacted] out of RALs.

The Examiner "Ratings Difference with EIC" question read "No" within ViSION for the October 25, 2010 [redacted] S&S ROE. This response indicates that the examiner agreed with the final CAMELS ratings issued to the bank. However, when interviewed by our office, the EIC for the examination, [redacted], and his Case Manager, [redacted], both stated that the EIC disagreed with the final CAMELS ratings issued to [redacted]. [redacted] made his disagreement known to both [redacted] and [redacted]. Despite the requirements in the Case Manager Procedures Manual, [redacted] did not document [redacted]'s disagreement but believed the EIC's verbal disagreement constituted [redacted]'s "contesting"[46] the rating. Ultimately, [redacted] acknowledged the difference of opinion but did not document it in ViSION.

For both [redacted] and [redacted], our review of the 2010 S&S ROEs found that changes to the EICs' work were not limited to the ratings. Changes, made by Case Managers, included additional commentary about the findings from the most recent Compliance ROEs for each respective bank, as well as altered verbiage to support the lower CAMELS ratings. For example, where an EIC described liquidity as "strong," it was changed to "acceptable."[47] In the interviews with examiners and supervisory staff, all described the changes as necessary to comply with [redacted]'s direction that the composite CAMELS ratings be lower for the two banks. However, every one of these individuals believed this direction was driven by someone in a more senior

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44 [redacted] explained that it was typical for him to talk about S&S examination findings with his counterpart in Compliance, who was [redacted], in the case of [redacted]. He recalled that [redacted] had been comfortable with the "[redacted]" composite submitted by [redacted].

45 See Appendix 6 for additional detail regarding this Compliance ROE.

46 The August 2008 OIG report recommended DSC maintain a record when there were changes to an EIC-proposed rating, even when the EIC does not ultimately contest that change. The guidance DSC issued does not address what constitutes an EIC "contesting a change." This should be clarified or management should simply document any change, whether contested or not.

47 For a more comprehensive list of changes, see Appendix 4.

position and potentially in the WO. None of these interviewees knew the identity of the source, and [redacted] declined to be interviewed by our office.

As discussed in more depth below, their instincts were correct. The WO was influencing the downgrades.[48] The details of the examinations follow.

A. The FDIC's Downgrade of [redacted] in the August 30, 2010, S&S ROE – Completed October 1, 2010

The August 30, 2010, [redacted] S&S ROE cited many of the violations previously identified in the bank's October 19, 2009 Compliance ROE.[49] The S&S ROE identified the continued presence of a deficient consumer compliance program as a serious regulatory concern. The S&S ROE noted [redacted]'s Board also needed to develop a comprehensive strategy to minimize the risks associated with the bank's Tax Refund Solutions (TRS) program. On the other hand, the S&S ROE documented significant capital improvements within the bank and strong asset quality (despite an increase in the volume of adverse classifications), and noted that earnings were strong and benefited from the favorable performance of the tax refund division. Additionally, the S&S ROE stated earnings from traditional bank activities declined, but [redacted]'s performance remained at a satisfactory level. The S&S ROE noted liquidity was acceptable, and sensitivity to market risk was moderate, but suitably managed.

After the overview of the bank's condition, the S&S ROE discussed the results from the most recent Compliance ROE. The report discussed the "[redacted]" Compliance ROE rating and the "Needs to Improve" CRA rating. Given these findings, the S&S ROE addressed the proposed Cease and Desist Order that would be issued pursuant to Section 8(b) of the Federal Deposit Insurance Act. The FDIC presented the proposed Consent Order to the Board on November 18, 2010.[50] The proposed Consent Order contained provisions addressing the bank's RAL product, strengthening of the bank's CMS, and restricting the expansion of third-party relationships.

The S&S ROE stated that the continued presence of an unsatisfactory CMS, and the lack of a comprehensive strategy to minimize risks associated with the TRS program, were significant supervisory concerns. Further, substantive violations of a repeat nature reflected negatively on the abilities of management to comply with consumer protection regulations and guidelines. These compliance issues resulted in the S&S ROE Management component rating of [redacted] We asked Lowe if [redacted] deserved a "[redacted]" management rating. Lowe said "no," though the bank was on the borderline, he could have made a case for a "[redacted]" in management.

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48 When we interviewed Chairman **Gruenberg**, as a part of this Inquiry, we asked if he had ever heard that the 2010 S&S examinations for [redacted] and [redacted] were downgraded based on input from the WO. He stated that he did not recall. When we asked [redacted] a similar a question, he stated that he does not know what happened and cannot recall today.

49 See Appendix 5 for additional detail of [redacted]'s supervisory history related to RALs.

50 When a bank agrees to stipulate to the provisions of a Cease and Desist Order it is often referred to as a Consent Order.

The S&S ROE included a section dedicated to discussing the loss of the DI, outlining the increased risk this posed to the bank, and encouraging management to carefully assess these risks. As discussed above at Section XIII, bank management was attempting to develop a plan that would address the loss of the DI in the underwriting process. This plan included offering smaller loans, minimizing concentrations in these products to mitigate the risk identified by examiners, and using alternative tools like LexisNexis.

The S&S ROE described [redacted]'s earnings performance as "currently favorable," qualifying that the bank may not be able to sustain this positive trend should the bank's TRS business decline, or management fail to develop an acceptable DI model. [redacted] experienced a significant increase in earnings from the June 30, 2009, Return on Average Assets (ROAA) of [redacted] percent to June 30, 2010, where ROAA was [redacted] percent due to increased earnings produced by the TRS operation. The S&S ROE noted, "[e]xcluding TRS net income and average assets, the bank-only ROAA is calculated at [redacted] percent for June 30, 2010" which was above the peer average of [redacted] percent."

[redacted] had strong financials, out-performing its peers in many categories. The table below compares [redacted] to its peer group as of December 31, 2010 (when [redacted] was a composite [redacted]-rated bank).

Key Ratio	[redacted] 12/31/2010	Peer Group 12/31/2010
Return on Average Assets	[redacted]	[redacted]
Net Interest Margin	[redacted]	[redacted]
Tier One Capital	[redacted]	[redacted]
Net Loss to Avg. Total Loans	[redacted]	[redacted]
Net Loss for Loans to Individuals	[redacted]	[redacted]
Net Loan Growth	[redacted]	[redacted]

Source: Uniform Bank Performance Report for [redacted]

The FDIC and the State of [redacted] (State) jointly conducted the August 30, 2010 S&S Examination. However, the FDIC and the State issued separate ROEs because they could not agree on an overall composite rating. [redacted], rated [redacted] a composite "[redacted]," while the FDIC rated the bank a composite "[redacted]." [redacted] told us that such divergence in ratings between the FDIC and the State is unusual.

B. Relevant FDIC Internal Communications Regarding the [redacted] August 30, 2010 S&S ROE Downgrade

On October 1, 2010, [redacted] wrote to [redacted] regarding the August 30, 2010 S&S ROE. ***"We've about beat this report to death as it's been censored, reviewed by the State EIC, and reviewed by the FOS [Field Office Supervisor]. I'm not quite sure if it still says what I originally intended…"***

That same day, [redacted] emailed Lowe, [redacted] **Bair**, [redacted] and others complaining about the recent Compliance Examination. **Bair** asked [redacted] what the status was and "[a]re there problems beyond RAL accounts?" [redacted] confirmed that the issues [redacted] raised "emanate from the RALs" and that the next step would be either a Consent Order or Cease and Desist Order. Later in the month, on October 12, 2010, a "Refund Anticipation Loans/[redacted] Bank Follow-Up Briefing" was scheduled by the **Chairman's** office. The required attendees included: **Bair**, [redacted], and [redacted].

[redacted] took notes at the October 12, 2010, meeting and listed the attendees as **Bair**, [redacted] and [redacted]. According to [redacted]' notes **Bair** asked, "[d]oes it make sense to force them out of this business? Regardless of product cost? Are we still helping consumers if we kill this product?" [redacted] noted that [redacted] replied, "yes, IRS is going to get refunds [to taxpayers] in 5 days…" (ellipse original) [redacted] also wrote that **Bair** stated, "[w]ill support if you want to drive them out with an impossible standard. I'll support. [But this isn't a product I want killed at this price.]" (brackets original)

On October 19, 2010, there were field-level discussions about the fact that the State and the FDIC would be issuing concurrent ROEs on [redacted] rather than a joint ROE due to disagreements on ratings. Those discussions continued with the WO the next day. Lowe emailed [redacted], copying [redacted] and [redacted], (and ultimately forwarded to [redacted] explaining there was a discrepancy between the State of [redacted] and the FDIC's proposed CAMELS ratings. ***"In discussions thus far, the state has indicated they are leaning towards a '[redacted]' on the management component, and a '[redacted]' composite. We continue pressing that the ongoing compliance related issues must be considered, and warrant a '[redacted]' on management, and a '[redacted]' composite."*** [redacted] ***responded by questioning a "[redacted]" composite rating. "[redacted], I've been thinking about this all day today and am worried about the thought process. The CP [Compliance] rating was [redacted], right? And we're about to finally issue an order and likely litigate. The [redacted] has to be somehow reliant on financial results of a major business line that we know is a threat to the bank."*** Lowe then explained the basis for the "[redacted]" composite rating as follows, "[t]he overall composite of '[redacted]' for risk management is based on several factors, including the low level of classifications, above average capital posture, and favorable liquidity and funding position. The bank's earnings are far above peer, and as expected, approximately [redacted] are derived from ERO related activities."

Between October 29, 2010, and November 1, 2010, [redacted] and Lowe exchanged emails. [redacted] wrote, "I am concerned that our safety and soundness exam is once again being sabotaged at a higher level… This has happened to us too many times, most recently with the Compliance and CRA Exam." Lowe responded that the "examination team is considering facets of the findings from the Compliance Exam in their conclusions," and the impact of elimination of the DI on [redacted] RAL underwriting.

Despite examiner objections, [redacted] was ultimately given a "[redacted]" composite for its August 30, 2010 S&S ROE. When interviewed by our auditors as a part of the Audit, Lowe told us that [redacted]'s composite rating probably should have been a "[redacted]" in that ROE. Moreover, and as referenced later, the fact that the final composite rating for the August 30, 2010 S&S ROE was not what the EIC had initially proposed was known in the WO. [redacted] wrote in notes dated January 14, 2011, "[a] review of ROE(s) would show the findings are considerably less favorable to the bank than what [the] EIC proposed."

As a part of this Inquiry, we asked [redacted] about these notes and he stated that he wrote the notes in anticipation of briefing [redacted]r. He said that the notes were an expression of his concerns about the litigation with [redacted]. [redacted] told us that he felt he needed to make [redacted] aware of the changes to the exams because, if the case made it to a hearing and an examiner was put on the stand, the examiner would be asked what the original rating was and why the exam rating was changed, and the examiner would have to answer. [redacted] stated to us that he was certain that he had been told that the exams were going to be seriously downgraded, but he did not recall exactly why. [redacted] further stated that the meeting with [redacted] was to inform him that FDIC Board members – **Bair**, **Gruenberg**, and [redacted] – were involved in the case against [redacted]. [redacted] explained to us that typical case issues did not usually go beyond he and [redacted] and he wanted to make sure [redacted] knew that this case had the interest of other Board members. [redacted] told us that most enforcement actions before the CRC only occur at staff level and to have more than [redacted] involved was unusual.

Also on January 14, 2011, in an email discussing draft briefing bullets for the **Chairman**, [redacted] wrote to [redacted] and [redacted], copying [redacted], "[a]lso, is there any way we can get in the point that discovery may well allow prior and contradictory exam reports in the case which could prove to be potentially embarrassing given the bank's supervisory history?" Equally, [redacted]' notes from a February 7, 2011 meeting with [redacted], and others reflect that [redacted] told this group that "[i]n the review process, the rating was changed."

C. Review of Revenues, Volume, and Charge-Offs

The WO continued to try to develop other potential issues with the RAL programs at [redacted]c as well as those at [redacted] and [redacted]. On Friday, October 22, 2010, and Monday, October 25, 2010, the [redacted] RO and Field Offices, through Lowe, provided information, on short notice, about what [redacted]'s financials would look like without ERO revenues, to [redacted],

[redacted] and [redacted]. Based on the ROAA for [redacted] as compared to its peers, [redacted] told [redacted] it “certainly supports a ‘1’ [rating].” [redacted] later wrote to [redacted] “…it certainly shoots down the claim that income from traditional bank operations doesn’t compare favorably to peer.”

On October 26, 2010, Lowe instructed [redacted] to have his staff prepare an analysis on the volume of RAL loans for the three RAL banks for the previous three years, including the amount of charge-offs incurred and the funding mechanisms for the loans. On that same day, [redacted] wrote to [redacted] “Big trouble in [redacted] – with a capital T that rhymes with DC that stands for………” (ellipse original). The work was completed on October 29, 2010. [redacted] provided Lowe with a summary outlining the funding strategy for the RAL products offered by the three banks. [redacted] attached data on the volume and charge-off percentages from the banks’ RAL portfolios (see chart below):

Tax Year	[redacted]			[redacted]			[redacted]		
	$ RAL Volume	$ Gross Charge-Offs	C/O as % of Gross	$ RAL Volume	$ Gross Charge-Offs	C/O as % of Gross	$ RAL Volume	$ Gross Charge-Offs	C/O as % of Gross
2010	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2009	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2008	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2007	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Essentially, all three banks’ gross charge-offs as a percentage of loans were very low. Neither [redacted] nor [redacted] charged-off over one percent of their RAL portfolio from 2007 through 2010 and [redacted] stayed under one-and-a-half percent during the same timeframe.

D. [redacted] Consent Order Addressing Both Compliance and Safety and Soundness Concerns

Language for the proposed [redacted] Consent Order (the Consent Order), that addressed the bank’s purported S&S and compliance issues, was revised over time and reviewed and edited at the highest levels of the FDIC. On September 14, 2010, [redacted] emailed [redacted], [redacted], [redacted], and others, copying [redacted], and asked, “what are the next steps for moving [redacted] to a resolution… E.g., do we need to go back to the **Chairman** for something?... Do we need to talk to [redacted] or the CRC? Other?” [redacted] replied to all:

The RO is meeting with the bank this morning to discuss what is in the report… After the meeting today, we will get together and come up with a timeline for next steps.

*We have sent all the information the **Chairman** requested to* [redacted]. *I have a meeting with him a[t] 1:00 and will determine if we need to meet with the **Chairman** again.*

I do believe we need to discuss a global settlement with [redacted]*; however, we didn't have time at the last meeting…*

On October 19, 2010, the same day that the OCC issued its supervisory letter to [redacted] regarding RALs, [redacted] wrote to [redacted] stating, "[redacted] would like another meeting on RALs as soon as possible." [redacted] replied that he would like to include [redacted] in the meeting and copied her. [redacted] responded just to [redacted], "I think [redacted] told [redacted] that the [[redacted] Consent] Order wasn't as strong as he thought." The meeting with the then-**Vice Chairman** was scheduled for the next day. That day, on October 20, 2010, [redacted] emailed [redacted], copying [redacted], [redacted] and others stating, "Marty [**Gruenberg**] has requested to meet with me and [redacted]. They'd like to be briefed on our proposed corrective Order on [redacted]…" [redacted] also stated that they wanted to be briefed on [redacted].

On October 25, 2010, [redacted] and [redacted] met regarding the [redacted] Consent Order and other RALs issues. According to [redacted]' notes from the meeting, [redacted] reported that he and [redacted] had met with [redacted] and **Gruenberg** and that **Gruenberg** "thought the [draft] order [as written] would provide a pathway to stay in RALs," and [redacted] told [redacted] "that we expect the set of events to cause them to get out of the RALs business – e.g. since 'Debt Indicator' will no longer be available from IRS."

On October 26, 2010, [redacted] emailed [redacted] and [redacted] copying [redacted] With respect to the [redacted] proposed order, he opined, "I continue to have trouble seeing a legal basis for the FDIC to tell banks, and tax preparers, how much they can charge in fees – which are disclosed, and which are avoidable if customers go through other providers. To me, that counsels against a FIL, as well as raising serious issues about any order provision that tries to do this."

[redacted] appeared to share [redacted] concerns and relayed them to the **Chairman** on November 10-11, 2010. "[There has been] a big change from the proposed [[redacted] consent] order that was presented to you at briefing last month." He went on, ***"I'm not sure what the legal basis is for these provisions. The only significant weakness identified at the last compliance examination (which started in June 2009 and was closed in October 2010) was inadequate oversight of third parties."***[51] He highlighted the particular changes that had been made:

The proposed consent order now contains a provision requiring the bank to submit a 'risk management plan' for managing risks associated with the bank's RAL program to the [redacted] *Regional Director. The consent order prohibits the bank from making any RALs 'unless or until'*

[51] It is significant that prior to becoming a [redacted], [redacted] had been with the FDIC in various capacities since 1989 and is well-qualified to opine on supervisory topics. He served as [redacted] He moved to headquarters when asked to come for a detail by [redacted]. While on detail, he met Chairman **Bair**, who asked him to join her staff.

the risk management plan has been approved by the [redacted]*. In addition, the proposed order stipulates that the bank's pricing for RALs 'is appropriate,' as deemed by the Regional Director.'*

The next morning **Bair** responded via email, "if we are making an issue out of pricing, it needs to be tightly connected to their inability to access info from Treasury about whether there are any liens on the refund. I do not want an order which in anyway suggests that we are imposing rate regulation. ***I also do not understand why we are imposing a hard stop in November. They told me months ago, they were going to let them phase it out. Why the shift?***"

[redacted] replied to **Bair**, in part, ***"I'm puzzled by the shift and the extreme sense of urgency now. After all, this exam has been in process for 1 ½ years. Legal and DSC staff have told me that*** [redacted] ***and*** [redacted] ***have been pushing for [a] more stringent order, and now that*** [redacted] ***is no longer offering RALs, they want all three of our banks out of the RAL business ASAP.*** [redacted] ***told me yesterday that DSC wants to have a hard stop as soon as possible before the next tax season starts."***

Pearce also recalled, during our interview with him, a discussion on November 11, 2010, about RALs during which [redacted] told him that [redacted] and **Gruenberg** wanted the FDIC banks to stop offering RALs.[52] [redacted] explained that he believed their rationale was that banks offering RALs were declining in number, and [redacted] the last national bank engaged in the RAL business, was told to stop offering the product by the OCC. That left the FDIC with the only remaining banks still in the RAL business.

It is noteworthy that [redacted] sent **Bair** a copy of the draft [redacted] Consent Order and included a portion of the text in an email for her to review specifically. The text was as follows:

Unless and until the Bank has implemented a Risk Management Plan acceptable to the Regional Director, effective immediately, the Bank:

a. *is prohibited from making or issuing any new RALs;*
b. *shall reduce the number of Electronic Refund Originators (EROs) in its Tax Refund Services (TRS) program to the number of EROs under contract for the 2010 tax season, which covers the 2009 calendar year; and*
c. *shall not add any new or replace any existing, Electronic Refund Originators, tax service companies, or any tax service providers.*

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52 [redacted] told us that then-Chairman **Bair** made it known in a meeting that she did not like RALs, but that she was not telling DSC what to do. [redacted] said that **Bair** told staff to do what they needed to do. [redacted] also told us that then-Vice Chairman **Gruenberg** did not like the RALs product. [redacted] stated that DSC was under the impression that FDIC Board members wanted the banks out of RALs. He further stated that neither **Gruenberg** nor [redacted] directly voiced to him that they wanted the banks out of RALS; rather, it was more of a feeling he got from them.

Bair took up the discussion of the wording of the [redacted] Consent Order, on November 11, 2010, with [redacted]. She wrote:

I'm confused about the order. If we are making an issue of pricing, it should be tied to their inability to get the relevant info from treasury to price. I don't want any suggestion we are imposing a 'rate' regulation. Also, I'm not sure I'm comfortable with the hard stop on all RALs. The original plan was to do a phase out. Why the shift? The financial impact will be huge. And we are late in doing this.

[redacted] responded, in part, copying [redacted] "The order stops them from making RALs until they have a comprehensive plan dealing with all aspects of the program, which includes underwriting, funding and compliance." **Bair** replied to [redacted] and [redacted]

…I am comfortable with a safety and soundness order tied to insufficient third party management and inability to price because of lack of all needed info from Treasury.[53] *You bring in the small dollar loan guidance, it muddies the waters and makes us vulnerable to charges of rate regulation which we don't have legal authority to pursue. The guidance relates to when a bank can get CRA credit. Banks can make higher rate small dollar loans and do. We don't have the [legal] authority to stop them based merely on rate.*

[redacted] responded that the draft order "doesn't expressly limit fees… Rate and fee issues ultimately need to be addressed if we are discussing an exit plan/settlement with the bank for 2011 after the initial Stip is presented to them." **Bair** responded by citing a section of the draft order that read "establish policies and procedures to ensure that the Bank's pricing schedule for its Tax Refund Solution (TRS) products, which include RALs, together with other document and processing costs connected to the Bank's tax refund services is appropriate, as deemed by the Regional Director." [redacted] stated he was willing to remove the word "appropriate" from that section "as long as there is a common understanding that any exit plan for 2011 would limit fees to 2010 levels."

Bair then forwarded the chain to [redacted] asking him to "[p]lease advise." [redacted] responded,

I recommended omitting this provision from the order. I don't think we're in a legally defensible position when we start dictating what is an appropriate price or rate. [redacted] ***raises concerns about potential UDAP***[54] ***issues. Examiners did not identify any UDAP violations at the most recent exam or any previous exams. Also, while the revised order is focused on safety and soundness, the most recent safety & soundness exam resulted in a composite 2 rating and***

[53] As discussed in section XIII A, a NOC based primarily on perceived safety and soundness concerns due to the lack of the DI was ultimately issued to [redacted] on February 9, 2011.

[54] "UDAP" is an acronym for Unfair, Deceptive or Abusive Acts and Practices that are violations of Section 5 of the Federal Trade Commission Act. 15 U.S.C. § 45.

the safety & soundness examiner-in-charge reportedly informed [redacted] board members that the bank's condition had improved or stayed the same as the previous examination.[55]

Again, at this time, [redacted] was the Chairman of the CRC. Legal and DSC had sent a "Recommendation to Pursue a Consent Order and Order to Pay a Civil Money Penalty" memorandum regarding [redacted] to the CRC on November 5, 2010. Legal and DSC then presented the [redacted] Consent Order to the CRC on November 15, 2010, just a few days after [redacted] and [redacted] were crafting its language. The CRC "by a unanimous vote, expressed no objection to DSC pursuing the Stipulated Consent Order and Civil Money Penalty [against [redacted] as requested." As with [redacted] involvement in the rejection of [redacted] RALs underwriting plan described above at Section XIII, [redacted] involvement in drafting the [redacted] Consent Order would seem to call the independence of [redacted] as Chairman of the CRC and the CRC process, in this instance, into question.

On November 12, 2010, [redacted] wrote to **Bair,** "FYI - The revised order is much better than the previous version. Thanks!" He forwarded the revised Consent Order and memorandum on [redacted] and noted revisions made. ***Lowe sent the Proposed Consent Order to [redacted] Board on November 18, 2010. The language on pricing that Bair was concerned about had been removed. However, the call for immediate exit remained.***

On November 3, 2010, just two days before staff submitted their memorandum to the CRC in favor of issuance of [redacted] first Consent Order and a CMP of $50,000, [redacted] issued a Regional Directors Memorandum changing the matrix used to calculate CMPs.[56] The CMP matrix is found in Chapter 10 of the FDIC's Formal and Informal Action Procedures Manual and uses weighted factors to assist supervisory staff in deriving a dollar amount range for a CMP. [redacted] did not update the manual, however, on November 3, 2010. Instead she sent a Regional Director Memorandum entitled, "Instructions and Matrix for Civil Money Penalties Against Institutions" to the field. In the Regional Director Memorandum, [redacted] increased the weights of certain factors in the matrix that would lead to higher CMP amounts where those factors were present. She also added other factors including, "weaknesses in the bank's third-party oversight that cause harm to consumers or the institution" and "a violation or practice that subjects the insured depository institution to substantial reputational risk or causes substantial harm to the public confidence of the institution." Using this harsher guidance, staff calculated a range for [redacted] CMP of $15,000 to $25,000. However, according to the memorandum to

[55] [redacted] was correct that a "2" composite rating for the August 30, 2010 S&S ROE was originally reported to the bank. However, as discussed above, this was later changed to a "[redacted]" composite.

[56] This change went through the CRC process. The agenda from the June 23, 2010 CRC meeting shows that [redacted] was to present to the CRC on revising the civil money penalties matrix. Later on October 14, 2010, [redacted] recommended the adoption of a "revised Civil Money Penalty Matrix Against Institutions (Matrix) for the calculation of a civil money penalty (CMP) against an institution or institution-affiliated party (IAP) that is a corporate entity." The contacts for this recommendation were listed as [redacted] and [redacted] For a complete list of the changes, see Appendix 7.

the CRC on November 5, 2010, regarding the [redacted] Consent Order and CMP, "given the extent of the violations, and the fact that the Bank has over $3 billion in assets and should have had a strong compliance management system, a higher CMP is justified in this case. For these reasons, a CMP in the amount of $50,000 is recommended." The CRC approved the $50,000 CMP – double the highest amount generated by the matrix.

WO staff were leading the messaging to, and negotiations with, [redacted] regarding the Consent Order and RALs. On November 21, 2010, [redacted] wrote to [redacted] and Lowe that "the time for talking with [redacted] is long past." He instructed them to tell [redacted] that he needed to contact the bank's Board about the Consent Order and if he would not, then [redacted] suggested contacting another director. [redacted] forwarded the email to the [redacted], [redacted],[57] stating "I would like to discuss this case with you tomorrow…"

On November 29, 2010, [redacted] notified [redacted] and [redacted] that [redacted] would be meeting with [redacted] on December 1, 2010, to present the Consent Order for stipulation. [redacted] and [redacted] all reviewed Q&A talking points submitted by the RO for the meeting. [redacted] also sent the talking points to [redacted] and [redacted] for their input. The next day, [redacted] sent feedback on the Q&A talking points for [redacted] to [redacted] and others in the RO, copying [redacted] [redacted] [redacted] [redacted] [redacted] newly-hired Supervisory Counsel, Enforcement, [redacted] [redacted] ([redacted])[58] and others. She wrote "[w]e have vetted your questions here in DC."

After [redacted] RO personnel met with [redacted] on December 1, 2010, [redacted] and others met, on December 3, 2010, to discuss how the meeting with [redacted] had gone. [redacted] took notes at the meeting. According to [redacted] notes, [redacted] stated that [redacted] "safety and soundness ROEs don't show concern." Lowe told the group that the S&S "ROE is about ready for issuance." [redacted] added, "[w]e don't see compliance issue now with RALs."

On December 6, 2010, [redacted] reviewed the [redacted] issue and emailed [redacted] and [redacted] that he wanted to discuss it with them. ***"I see little chance that we can directly force*** [redacted] ***out of the RAL business for 2011, so an agreement regarding 2012 without the need for litigation seems like a good compromise."*** [redacted] responded that he agreed and had discussed the issue with [redacted]

By December 10, 2010, [redacted] was looking for a more definitive response from [redacted] He emailed Lowe, [redacted] [redacted] [redacted] [redacted] and [redacted] "We need a yes or no – will [redacted] agree to exit the business after this year? If the answer is yes, then I think there is room to negotiate the rest. If not, I see no reason to negotiate further." He asked Lowe to contact

[57] October 12, 2010 Press Release that [redacted] was appointed by FDIC and was to begin work in early November.

[58] November 8, 2010 Announcement by [redacted] that [redacted] [redacted] was joining FDIC's Enforcement Section.

[redacted] for clarification. On December 15, 2010, [redacted] wrote to [redacted] that [redacted] would not commit to exit the RALs business after the tax season. She added, "I will go forward with our call with [redacted] tomorrow." (See Section XVI for more detail on [redacted] interaction with [redacted]

E. The FDIC's Double-Downgrade of [redacted] in its October 25, 2010 S&S Examination – Completed January 19, 2011

The FDIC double-downgraded [redacted] in its October 25, 2010 S&S ROE to a [redacted] composite from the [redacted] it had received at its March 23, 2009 S&S Examination. The October 25, 2010 S&S ROE's "Matters Requiring Board Attention" section related solely to concerns identified in the then-pending May 15, 2009 Compliance Examination.[59] Equally, the primary topic of the S&S ROE, more generally, included concerns identified in the then-pending May 15, 2009 Compliance Examination regarding [redacted] RAL and non-traditional lending programs. Within the "Examination Conclusions and Comments" section of the S&S ROE, the first page and a half described only Compliance Examination concerns. Further, the "Management" portion of that section that explained the rationale for the [redacted] Management component rating, exclusively discusses compliance-related concerns. Notably, the then-pending May 15, 2009 Compliance Examination violations were primarily due to the bank's adjustable-rate mortgage (ARM) re-pricing practices. The S&S ROE component and composite ratings were as follows:

Component	Rating
Capital	[redacted]
Asset Quality	[redacted]
Management	[redacted]
Earnings	[redacted]
Liquidity	[redacted]
Sensitivity to Market Risk	[redacted]
Composite	[redacted]

The S&S ROE noted that the bank's reviews of its RAL program were inadequate; however, the prior year's S&S ROE did not note any concerns or inadequacies with the review completed by Jefferson Wells, Inc., who assessed ERO compliance with [redacted]'s bank policy and procedures.

The discussion of earnings included a comment on the negative impact to earnings that would result if the tax business line was terminated. RALs income made up [redacted] percent of the bank's 2010 income. Termination of this program impacted the bank's net interest margin which

59 For additional supervisory history, related to RALs, for [redacted], See Appendix 5.

compares the bank's interest earning assets (*i.e.*, loans to customers, investments, etc.) to liabilities (*i.e.*, deposits, notes payable, etc.). A weakened net interest margin puts earnings pressure on the bank to support its operations.

Financially, the bank experienced improvements in 2010 over 2009. Examiners noted improvement within the asset quality component of the bank. Return on Average Assets went from [redacted] percent in 2009 to [redacted] percent in 2010. Delinquent loans declined from [redacted] percent in 2009, to [redacted] percent in 2010. Tier 1 leverage capital increased from [redacted] percent in 2009 to [redacted] percent in 2010. Finally, the bank's net interest margin (net interest income as a percent of average earning assets) improved from [redacted] percent in 2009 to [redacted] percent in 2010. The table below compares [redacted]'s financial ratios to those of peer banks. In every metric below, except its net loss for loans to individuals, [redacted] outperforms the peer group.

Key Ratio	[redacted] 12/31/2010	Peer Group 12/31/2010
Return on Average Assets	[redacted]	[redacted]
Net Interest Margin	[redacted]	[redacted]
Tier One Capital	[redacted]	[redacted]
Net Loss to Avg. Total Loans	[redacted]	[redacted]
Net Loss for Loans to Individuals	[redacted]	[redacted]
Net Loan Growth	[redacted]	[redacted]

Source: 2010 Uniform Bank Performance Report for [redacted]

The FDIC's recommendations to the bank resulting from the S&S ROE included improving the quality of the methodology of the allowance for loan and lease losses, the profit plan, and the audit function.

F. Relevant FDIC Internal Communications Regarding the [redacted] October 25, 2010 S&S ROE Double-Downgrade

While the October 25, 2010 S&S ROE was the culmination of the FDIC's work on the [redacted] examination, one can ascertain the process utilized to reach [redacted]'s final rating by evaluating communications between examiners in the field, [redacted] RO staff, and management in the RO and WO.

On October 21, 2010, ***prior*** to the opening date of the October 25, 2010 S&S Examination, one day after [redacted] expressed concern to him about the proposed "2" S&S rating for [redacted] and in light of weaknesses identified in the then pending May 15, 2009 Compliance ROE, Lowe sent a draft letter addressed to [redacted] to his staff. The draft letter told the bank that the FDIC was proposing a Consent Order "directed at facilitating your exit from RAL lending and other such programs" and alerted it of the fact that it would be downgraded to a [redacted] composite in the bank's S&S examination. Lowe instructed [redacted] ***"once the letter is sent, please ensure the RM [risk management] items are downgraded."*** That same day, Lowe sent the same draft letter to [redacted] and [redacted] for their feedback and assured them that they would also see the draft order before it went to the bank. [redacted] replied to Lowe, copying [redacted] and [redacted], ***"[t]hanks for planning to send the [redacted] [sic] Order to [redacted] and me. I want to make sure that we won't conflict with any provisions that we intend to include in on [sic] [redacted] Also since [redacted] is going to [redacted] at the CRC, I want [redacted] to be in a position to tell him about it ahead of time in case there would be some reason to think ahead on the order presentation to the banks."***

Between October 21 – 25, 2010, the chain of emails between Lowe and [redacted] copying [redacted], and [redacted] continued. [redacted] wrote, ***"They [redacted] must be crazy to proceed without the debt indicator??" Later, he added, "The RO has a responsibility to make sure that the bank is not taking a damaging risk. Is that your plan? The tax season must be starting about now. It's a huge red flag, if my understand[ing] is correct, that [redacted] is willing to suffer through litigation in order to protect itself." Lowe replied simply, "[t]hat is the plan."***

As described previously, by November 18, 2010, field staff were aware of Lowe's instruction to [redacted] to "…make sure our examination team at [redacted] is closely considering the bank's business plan, and potential changes and impacts relative to RAL lending, and that the compliance findings are fully considered in the management and composite [S&S] ratings."[60]

As of December 6, 2010, the S&S ROE was still in process; however, internal correspondence from Lowe confirms the plan was to issue a proposed Cease and Desist or Consent Order against [redacted] for lax oversight of its third-party programs, including RALs, which mirrored the language used for the [redacted] Consent Order. The Order required improved oversight of third-party products and noted preliminary findings from the ongoing examination, in particular: nominal oversight of nontraditional activities and reliance on third-party vendors to administer consumer compliance for each product, including marketing materials and training, and the need for improvement in ERO monitoring, due diligence, and documentation.

Ratings discussions for [redacted] occurred on December 7, 2010. There was a view that [redacted]'s rating should be consistent with [redacted]'s. That, in and of itself, is not necessarily problematic because one of DSC's (now RMS's) tasks is to ensure consistent treatment across

[60] Email from Lowe to [redacted] no subject, November 2, 2010.

the institutions it supervises.[61] At this juncture a [redacted] composite rating was discussed, rather than the [redacted] composite rating that the examiners and first-line management had initially wanted because, according to them, "there are other factors at play here;" and "[c]onsidering what has transpired with [redacted] (very political), I'd be surprised if we go with a [redacted] composite especially since [redacted] has pretty strong controls and oversight of their programs, and [redacted] is severely lacking. [redacted] is getting an overall [redacted] – based on risk management findings alone it would be a composite [redacted];" and "there may be other agendas or politics in play at the RO senior management level…" On December 8, 2010, [redacted] wrote to [redacted] and [redacted] that "[g]iving [redacted] a composite [redacted] seemed like an enormous stretch based on the overall exam findings. I don't think it will be a big stretch to make [redacted] a [redacted]."

On December 27, 2010, an examination exit meeting was held with the bank's management regarding [redacted]'s Compliance ROE. [redacted] told the bank it would face an enforcement action that would require the bank to exit both tax and social security products. It is noteworthy that, at the time, [redacted]'s tax products accounted for 66 percent of the bank's income as of June 30, 2010. As of December 30, 2010, [redacted]'s ROAA was 1.32 percent. Income generated from the RALs and the [redacted] made up about 70 percent of the total ROAA. The May 15, 2009 Compliance ROE was completed and mailed to [redacted] on December 30, 2010. However, UDAP matters remained pending and were under review by the WO, with placeholders left in the report. The [redacted] was scheduled to be part of a nationwide horizontal review of its ERO providers planned by the WO. The Consent Order remained in process and included requirements to address CMS weaknesses and to exit the tax division business (which included RAL products).

On January 5, 2011, [redacted] emailed Lowe, copying [redacted] and others, and noted that examiners had found no major concerns during the S&S Examination for [redacted]. By this point, the EIC had conceded to the ratings [redacted]; however, the email noted the Management component could be decreased once they saw the final Compliance ROE to ensure it accurately reflected compliance concerns.

Financially, according to [redacted] email, it appears the bank maintained a strong balance sheet. The Bank's Tier [redacted] leverage capital was approximately [redacted] percent, and classifications approximated [redacted] percent, a decrease from the previous S&S Examination. The bank's liquidity was strong, with moderate sensitivity that examiners felt management was adequately

[61] The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions Examination Council (FFIEC) on November 13, 1979, and updated in December 1996. "Over the years, the UFIRS proved to be an effective supervisory tool for evaluating financial institutions on a uniform basis and for identifying institutions requiring special attention… Under this system, the supervisory agencies endeavor to ensure all financial institutions are evaluated in a comprehensive and uniform manner, and that supervisory attention is appropriately focused on institutions exhibiting financial and operational weaknesses or adverse trends."
(BASIC EXAMINATION CONCEPTS AND GUIDELINES, Section 1.1)

monitoring. [redacted]'s Bank Secrecy Act and information technology examinations did not reveal any material concerns. [redacted] indicated to Lowe, [redacted] and others that "if not for the bank's material Compliance problems, and third-party risks – this would likely have been a composite [redacted] bank." Correspondence identified coordination between DCP and RMS in the WO because the S&S findings were clearly predicated on the Compliance results.

On January 19, 2011, field staff told [redacted] that "…Washington wants to review the draft [[redacted]] report, so I wanted to get it into their hands ASAP." When interviewed as a part of this Inquiry, [redacted] told us it is unusual for draft examinations to be reviewed in the WO prior to being finalized by the RO. [redacted] said she cannot say it never happens, but it is rare. In general, for a draft report to come to the WO, she told us there has to be an "extraordinary issue."

Ultimately, [redacted] received a management component rating of [redacted] [redacted] told us it was uncommon for a bank to have [redacted] and [redacted] component ratings across the board but have a [redacted] management rating. However, she said it was "not out of the realm of possibility." Overall, [redacted] received a composite rating of [redacted] for its October 25, 2010 S&S Examination, though no component rating, other than management, was less than a [redacted]

XVI. Beginnings of the Idea to Pursue a Horizontal Review and Weaknesses in the Case Against [redacted] that Spurred the Review Forward

On December 16, 2010, [redacted] wrote to [redacted] copying [redacted] Pearce, and [redacted] that [redacted] had declined to stipulate to the proposed Consent Order. She further stated that, ***"[t]he bank has also submitted a plan to compensate for the lost [sic] of the debt indicator. We would have a stronger case if we spent some time...going back into some of the EROS to identify control weaknesses and exposure to the bank. We would focus these reviews on areas we think the bank's oversight is most vulnerable."*** Benefits listed included, "[w]e have [sic] will have more support of poor third party oversight that will stand up in an Order."; "[w]e can expand the action to address all tax refund products, not just RALs"; and "Legal will more likely support the Notice [of Charges] after we get more information." [redacted] closed by saying, "[w]e can discuss in more detail tomorrow."

Pearce asked [redacted] and [redacted] on December 22, 2010, to outline strengths and weaknesses of a RAL case against [redacted] including an assessment of the merits on both debt indicator and third-party oversight issues and likelihood of success, both with and without additional examination efforts. He also discussed the idea of a "random selection of EROS, [and then] visits without notice to the institution."[62] This process is known as a horizontal review. Pearce then told [redacted] and [redacted] that:

Based on our conversation with [redacted] earlier this week and conversations I've had with Marty [Gruenberg] and Sheila [Bair] I think we will be best served having a document to describe the strategy of dealing with [redacted] and the options for moving forward (e.g. file the action now with the evidence we have vs. expending additional resources to assess other areas in the upcoming tax season through a horizontal review of RAL banks). There is some skepticism that we will be in a different position in six months, and before we shift gears, I want to have some meaningful conversations with Board members. In particular, am sensitive to [redacted] view that now may be the best time to move forward. I don't want to pull the plug without having a fulsome conversation on strategy… I want to get Board members on the same page on this case and having a staff assessment might be helpful in getting to that end.

On December 28, 2010, [redacted] asked Pearce whether the OCC's actions against [redacted] changed Pearce's "recommendation to defer bringing a Notice against [redacted] until a special examination concludes in 1Q 2011." Pearce replied, "[a]fter talking with you, Marty [**Gruenberg**], and Sheila [**Bair**] about this over the past week, I have asked staff to prepare a memorandum to summarize the strengths/weaknesses of our case and our options. I doubt my recommendation will change, but want to make sure we are giving you a full picture of the case and the pros/cons of possible next steps."

When interviewed by our office, Pearce stated that he was responsible for the horizontal review, a strategy he advocated for any bank with a RAL business.[63] He put [redacted] in charge of the review. According to Pearce, the "RAL strategy" was to understand third-party oversight by the banks, and he believed the best way to do that was during tax season. The horizontal review was the mechanism he decided would be useful for all three institutions, but "certainly [redacted] was the focus."

On December 29, 2010, Pearce reached out to the [redacted] RO to ask about [redacted]'s examination exit meeting. [redacted] replied via email to Pearce, copying Lowe, [redacted] and [redacted] that a Consent Order mirroring [redacted]'s was prepared, but "as discussed during our

62 According to the Report of Visitation that was written following horizontal review, the decision not to provide advanced notice of the horizontal review was made "due to reports by examiners, who conducted the on-site FDIC ERO visits in March 2010, that ERO representatives appeared to have been 'coached'" by [redacted] No similar accusations had been made about the other two RALs banks that were slated to be subjects of the national horizontal review.

63 **Bair** told us "[redacted] was handled by Mark Pearce. I was kept informed, and if I authorized anything, it was upon his recommendation. (I do remember this being discussed during our policy meetings and challenging staff about whether we should pursue an institution-specific supervisory and enforcement strategy without first defining our overall policy toward RALs.) As you know, enforcement cases were not processed through the Chairman's office, but rather went through a special case review committee chaired by an FDIC director."

teleconference," the examination report was sufficient to request [redacted]'s exit of "several third party business lines" with the goal being to get the bank out of RALs after the then current tax season. [redacted] also noted that the [redacted] RO planned to conduct visitations of EROs in February. [redacted] then wrote to Pearce, Lowe, and [redacted] copying [redacted] to clarify. He stated that RO Legal would consult with the WO to revise the proposed [redacted] Consent Order to include RAL and third-party activity in anticipation of presenting the Consent Order at the bank's February Board meeting. He added, "[i]t has been stated previously that the WO (Sylvia) is developing a plan for conducting onsite visitations of the EROs for [redacted] and other RAL lenders." Therefore, the [redacted] RO would hold off on conducting its own visits so they would not conflict with WO initiatives. Pearce replied "[t]hanks for clarifying. This all sounds great."

The horizontal review initiative became important enough to be considered for addition to the FDIC's 2011 Corporate Performance Goals. Ultimately, it became a Division-Level Goal for 2011 to conduct a collaborative RMS-DCP horizontal review of banks engaged in RAL programs to assess the safety and soundness of program management and compliance with applicable law, including guidance on unfair and deceptive acts or practices.

The specifics began to take shape in January 2011. On January 2, 2011, Pearce wrote to [redacted] copying [redacted] ***"[we] need to move quickly on our RAL strategy… I'd envision a multi-Region team of examiners doing sweeps of tax preparers in a 'blitz' (e.g. one week period). We need to develop a specific checklist of things to look for, based on our prior conversations… I'll want to see the list prior to finalization. We need to run this from Washington, since it is a horizontal review with a national scope."*** [redacted] agreed. On January 3, 2011, [redacted] then notified Lowe, [redacted] [redacted] and [redacted] that "[a]s previously discussed we have decided to conduct a horizontal review of EROs... I will lead the initiative from the WO" and that the national initiative would replace any planned RO reviews.

On January 6, 2011, a "Draft Litigation Risk Assessment Memorandum for [redacted] was sent by [redacted] to [redacted] [redacted] [redacted] [redacted] [redacted] and [redacted] and the final was sent to Pearce on January 7, 2011. [redacted] wrote, ***"[o]ur conclusion is that, given both the*** [redacted] ***supervisory history and currently known information, litigation risk is high."*** Later he goes further, ***"[t]he Legal Division believes the litigation risk in relying primarily on safety and soundness arguments to eliminate the RAL product line is extremely high…"***

[redacted] explained that while, at the time, [redacted] was operating under a Cease and Desist Order issued on February 27, 2009, the ***"Order does not restrict the*** [redacted] ***ability to offer TRS products generally,"*** and that the recently issued Compliance ROE reflected that ***"deficiencies previously criticized in the RAL have been corrected…"* and *"contains very little, if any, direct criticism of the Bank's RAL lending and no criticism of the*** [redacted] ***other TRS products."*** He continued:

Section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. §1818(b), sets forth the FDIC's authority with regard to issuance of a Cease and Desist Order… Generally speaking, while section 8(b) allows for imposition of an order requiring corrective action or affirmative relief, the remedy sought by the FDIC must have a reasonable nexus to the complained of violations or practices.

[redacted] concluded, "[t]here is a very limited nexus between these concerns and the [redacted] RAL and TRS program." He also stated, ***"[w]e are not aware of any examination staff, at this time, in a position to opine as an expert witness that some deficiency in the TRS or RAL program, observed to date, rises to an unsafe or unsound practice, or that the Bank is faced with abnormal risk of loss from the program.***

[redacted] further concluded, ***"[b]ecause of the substantial litigation risks from proceeding with a Notice of Charges against [redacted] on the TRS and RAL lines of business at this time, we recommend the FDIC hold any enforcement action in abeyance pending the proposed horizontal visitations of the EROs."***

On January 8, 2011, [redacted] wrote to the [redacted], Pearce, [redacted] and [redacted] and went further than [redacted] did in the memorandum. "[redacted] ***supervisory history will ensure we lose given the examiners' earlier conclusions -- unless the debt indicator somehow changes the whole equation, which I don't think it does in our case, at least not yet, because we are a day late and dollar short for this tax season. In my judgment, we have a very low--I'd say barely 50%--chance of success."***

[redacted] also explained, on January 7, 2011, that the FDIC's position with respect to [redacted] differed from the OCC's with [redacted] "OCC told [redacted] to get out of the RAL business unless they could come up with an acceptable underwriting plan – in the absence of the Debt Indicator from the IRS. [redacted] submitted at least two plans that were deemed 'unacceptable'" and ultimately agreed to exit the business at the OCC's request. [redacted] pointed out that the FDIC had not yet analyzed the plan submitted by [redacted] and that [redacted] was not willing to voluntarily exit the business.

On January 7, 2011, Pearce wrote to [redacted] and [redacted] copying [redacted] and [redacted] ***"we should all get together next week to discuss options and strategy" for the three RAL institutions. On January 9, 2011, Pearce wanted information to brief the Chairman and [redacted] about "our strategy around tax refund products" the following week. The draft agenda for that meeting included the following topics: RALs vs RACs (Refund Anticipation Checks), a discussion of the three banks in RALs, OCC and [redacted] the horizontal review, and strategic options, including goals.***

On January 10, 2011, [redacted] emailed Pearce, following up on their December 28, 2010 exchange, about when [redacted] could expect the [redacted] options memorandum. Pearce replied via email to [redacted] that day and attached the January 7, 2011 Litigation Risk Assessment Memorandum. Pearce also stated in the email that he wanted to meet with [redacted] briefly that day or the next day, that he would arrange a full briefing for [redacted] and **Bair** later that week, and that ***"I think there are different staff perspectives on strategy and it will be helpful for you [redacted] and Sheila [Bair] to hear different views and provide feedback."*** [redacted] replied that he could meet with Pearce on January 11, 2011.

On January 14, 2011, [redacted] sent [redacted] [redacted] [redacted] [redacted] and Pearce a list of "pros and cons" regarding asking [redacted] to exit RALs or filing a NOC against them based on the bank's RAL program. "Pros" included exhibiting consistency with other regulators, "clearly express[ing] the FDIC's concern that RALs are an unnecessary and unacceptable small dollar loan product," showing the FDIC's commitment to protecting consumers, decreasing [redacted] reputational risk, and providing an expedient exit from RAL lending. "Cons," included but were not limited to, the fact that no formal examination had occurred while the new underwriting standards proposed by [redacted] were in place, that the new underwriting standard was untested and therefore hard to prove unsafe and unsound, that the bank's underwriting plan appeared to , "involve at least as much underwriting as the FDIC appears to think adequate," in its Small-Dollar Loan Pilot, and that the bank's RAL program had a historically low default rate. WO Legal concluded, ***"[t]here would be a very high litigation risk if the FDIC were to issue a Notice and try this case. We estimate that our chances of success are significantly less than 50%."*** When interviewed as a part of this Inquiry, [redacted] said that the FDIC almost never brings cases forward where there is a belief that it has less than a fifty percent chance of winning.

In handwritten notes that [redacted] took on the same day, he wrote under the heading "Cons":

We cannot legally order or otherwise direct them [[redacted] to stop RAL loans – absent [redacted] consent – except through [a] Notice [of Charges] + [and] hearing.

[There is a] [h]igh risk that we would lose a hearing badly – with a court concluding, e.g., that [redacted] underwriting is at least as good as what we endorse for [the] Small-Dollar Loan Pilot (or have accepted elsewhere).

A Congressional reaction is certainly possible.

A review of ROE(s) would show the findings are considerably less favorable to the bank than what [the] EIC proposed.

[redacted] had also conveyed some of these concerns, the previous day, by email, to [redacted] and [redacted] copying [redacted] and [redacted] "I am concerned about the litigation risk (and related FDIC reputational risk) of going forward with a Notice of Charges based on this analysis [of FDIC's review of [redacted] underwriting plan]."

[redacted] told us that she was aware of the legal "pros and cons" of bringing an enforcement action against [redacted] because she was working with [redacted] on the issue at the time. [redacted] agreed that there were many more cons to taking action against [redacted] and stated that she agreed with all of [redacted] cons. When asked why they continued to press regardless of all the cons, she said that was what her supervisor, [redacted] wanted and again cited the rhetorical question regarding [redacted] – if that size bank cannot manage RALs, how could [redacted]?[64]

[redacted] replied to the group above on [redacted] email with additional "pros" for them to consider. [redacted] believed that action was supported by, among other things, "a specific finding from FDIC examiners who are credible retail credit experts,"[65] the FDIC's supervisory approach of mitigating "identified substantive risk before there is damage," the deterrent effect it could have on other banks, and the reduced supervisory resources required if [redacted] agreed to settle and exit the RAL business.

Then on January 16, 2011, discussions turned to what would be said at the [redacted] Board meeting, scheduled for January 19, 2011, to cover both the Compliance and S&S ROEs. [redacted] stated to [redacted] and Pearce, copying [redacted] that [redacted] would "express disappointment that there was no agreement to exit RALs and say we are considering other options."

On January 17, 2011, [redacted] wrote to [redacted] that he would support DSC with respect to the actions they wished to take against [redacted] but ***"the risk management case on RALs is not that strong, so I would like to go after them on consumer issues."*** He asked about the least cost method of getting them to consent. "If we have to, then let's do the horizontal, but that's ultimately your [[redacted] and Mark's [Pearce] call." [redacted] shared [redacted] view. On January 20, 2011, [redacted] ([redacted], and Pearce were included on an email chain about the draft letter to [redacted] asking them to exit RALs. When the discussion turned to next steps should the bank refuse to exit, [redacted] agreed that the ***"Legal Division would be prepared to go forward with a Notice [of Charges] if that was the strategy DSC wants to follow" but it "would involve high litigation risks."*** Despite the burden of proof[66] resting with the FDIC to show that [redacted] RAL program was problematic, [redacted] wrote to Pearce, [redacted] and [redacted] that [redacted] ***"will not cease his RAL program" and it "is up to him to demonstrate that this is not unsafe or unsound."***

64 The FDIC appears to have based its strategy for eliminating RALs from its institutions based, in part, on a theoretical argument rather than hard evidence which, once collected, generally demonstrated that [redacted] was able to adequately manage the risks of its RAL programs.

65 The retail credit experts were not, however, in [redacted] words or their own, RAL experts. See Section XIII.

66 According to the RMS Manual of Examination Policies, "…mere suspicion is not sufficient grounds to institute this enforcement proceeding. Any such action must rationally be based on facts and evidence, as the FDIC has the burden of proving formal charges set out in a Notice of Charges."

Gruenberg was briefed on RALs by Pearce and others on January 20, 2011. When interviewed, as a part of this Inquiry, he said he did not specifically remember the "pros and cons" memorandum. He also stated that, as Vice Chairman, he had no formal role in reviewing this type of memoranda. [redacted] told us that Legal presented the litigation risk to the CRC and, though a factor, it was not determinative as to whether to go forward against [redacted]

XVII. [redacted] Attempt to Negotiate [redacted] Exit from RALs

In late January 2011, [redacted] began working to get [redacted] to consent to exit RALs through a Written Agreement rather than a Consent Order. As [redacted] explained during his interview for this Inquiry, if [redacted] refused to sign the Written Agreement, the next step would be a NOC that would have to go through the Administrative Law process. The terms of the NOC would have to hold up in front of the Administrative Law Judge. A Written Agreement, on the other hand, would allow the parties more leeway to simply negotiate and agree to terms.

On January 26, 2011, [redacted] wrote to [redacted] [redacted] and [redacted] copying [redacted] and [redacted] ([redacted] forwarded the email to Pearce, [redacted] and [redacted] that:

*…[redacted] and I called [redacted] to ascertain whether he was willing to work toward a settlement where the bank would exit the RAL business for the 2011 tax season, which from the bank's perspective begins in March. [redacted] seemed very receptive to the idea… **He expressed interest in being approved for the supplemental bid list, and I told him that this could be something that was on the table**.*

As described in detail later at Section XXXI, the FDIC's bidders list is a list of banks that are qualified by the FDIC, based on their ratings and financial conditions, among other factors, to purchase failing institutions. [redacted] CRA "Needs to Improve" rating based on the spousal signature violation (that even Bair questioned[67]) and composite [redacted] S&S rating would typically be too low to qualify it for the FDIC's bidders list.

[redacted] then emailed [redacted], copying Lowe and [redacted] and stated that they could discuss ***"conditions under which the bank would be allowed to bid on failing banks once this Written Agreement or a similar document is executed and an acceptable plan to exit the RAL business is filed. This can be handled through our normal business plan change process."*** She forwarded the email to [redacted] [redacted] [redacted] and Pearce, copying [redacted] [redacted] and [redacted] and added that "…[redacted] is amenable to pursing a settlement whereby [redacted] [redacted] exits the RAL business. He has several conditions on his wish list, most of which we can accommodate without much problem."

However, on January 31, 2011, [redacted] stated that she and [redacted] had spoken with [redacted] that day, and on January 28, 2011, and that [redacted] ***was amenable to exiting the RAL business***

67 See Section V supra.

if his conditions were simultaneously met which "is simply not workable."* [redacted] *reported that, "I have stated in no uncertain terms that signing the Written Agreement is a pre-requisite for beginning the bid list access process, which needs to occur in the context of a business plan change."

When interviewed, [redacted] told us that [redacted]ger, in their very first conversation, told her he wanted [redacted] to be on the bid list for failed banks. She believed she had told [redacted] that to do so, [redacted] would first need to exit the RAL business. She told him she believed if the bank did that, it would eliminate both compliance and S&S concerns and would certainly pave a path to getting on the bid list. She did not think this was unreasonable. However, according to [redacted] [redacted] wanted it in writing that if [redacted] exited, it would get on the bid list. [redacted] said that she could not make such a promise. [redacted] believed the bank's RAL business was the primary issue causing problems for the bank and that if [redacted] was to "get rid of the offending issue" it would be fine, as it was an otherwise well-run institution. [redacted] said she did not promise a ratings upgrade, but she said that it stood to follow that if [redacted] exited, "everything else would be good."

XVIII. [redacted] Appeal of the August 30, 2010 S&S Examination

On January 24, 2011, [redacted] sent a letter to [redacted] acknowledging that the bank had received the August 30, 2010 S&S ROE on December 2, 2010. [redacted] by that time, had also received a proposed Consent Order, on November 18, 2010, relating to its TRS business. In his letter, [redacted] addressed, among other issues, the disparity in rating between the FDIC's composite [redacted] rating and the State of [redacted] composite [redacted] rating for the bank. He also noted that the [redacted] had recommended a composite [redacted] rating and had told the bank's Board at a meeting, on September 15, 2010, that "they [the examiners] look at the tax business from a risk assessment standpoint and the audit function looked very strong. He also stated that the financial performance at TRS was extremely strong and so far, he has noted that no safety and soundness issues exist that are related to the tax business."

On January 28, 2011, [redacted] sent a letter to [redacted] copying [redacted] alerting them that [redacted] planned to appeal the [redacted] composite rating. He also requested additional time (until March 15, 2011) to do so, given settlement negotiations between the bank and FDIC were ongoing. [redacted] granted [redacted] request for an extension to file its appeal on January 28, 2011. She provided a new deadline for appeal of March 30, 2011.

If an institution receives an ROE or other written communication that contains disputed material supervisory determinations, the institution may submit a written request for review to the Director of DCP (for compliance issues) or the Director of RMS (for safety and soundness issues) within 60 days following the receipt of the ROE or written communication. Then, the DCP or RMS Director will issue a written determination within 45 days of receipt of the bank's written request. An institution that does not agree with the written determination by DCP or RMS may file an appeal with the FDIC's Supervision Appeals Review Committee (SARC) within 30 days from the date of the written determination. The SARC is comprised of three voting members, drawn from the most senior management levels at the FDIC, and the FDIC's General Counsel, who is a non-voting member of the committee. The SARC will notify the institution, in writing, of its decision concerning the disputed material supervisory determination(s) within 45 days from the date the SARC meets to consider the appeal. The meeting will be held within 90 days from the date the appeal is filed.[68]

[redacted] sent its appeal of the August 30, 2010 S&S ROE to [redacted] on February 4, 2011. [redacted] sent a letter, dated February 10, 2011, denying the appeal. The primary reasons offered for the denial were that the bank had been notified of a proposed formal enforcement action on November 18, 2010, and that a Notice of Charges was issued against the bank on February 9, 2011. The enforcement process supersedes and terminates a bank's right to appeal.[69]

On February 16, 2011, and as discussed in more detail below, [redacted] emailed Lowe, copying **Bair**, [redacted] and **Gruenberg**, "[i]t is baffling why the FDIC, on January 28th, would encourage and grant us an extension to file the appeal until March 30th if our right to appeal had already terminated." As discussed below at Section XXIII, no clear explanation was provided to [redacted] by the FDIC that addressed why an appeal extension was granted if no appeal right existed at the time.

XIX. Planning for, and Approval of, the Horizontal Review

On January 27, 2011, [redacted] and Pearce met with **Bair** about a potential horizontal review of the banks offering RALs and their EROs. [redacted] discussed the loss of the DI and Pearce covered the horizontal review. [redacted] notified [redacted] of the meeting. That same day, Pearce wrote to **Bair**, copying [redacted] and [redacted]

[redacted] approach on the debt indicator is showing promise. However, in the event it is unsuccessful, we are preparing for a horizontal review of third parties (tax preparers) offering bank products in early February. As I mentioned at the policy meeting, unannounced visits to tax preparers is likely to generate complaints from the banks and tax preparers. If it becomes public, I'm sure there would be press interest. Given all this and the resources required to do this well, [redacted] and I would like to brief you on this as soon as you have time available – 15 minutes should be enough. If you have concerns on our approach, it'd be good to flesh them out before examiners and legal ramp up the final planning.

68 https://www.fdic.gov/regulations/laws/sarc/sarc.pdf; The FDIC's *Guidelines for Appeals of Material Supervisory Determinations* (Published at 77 Federal Register 17055, (March 23, 2012); http://www.fdic.gov/regulations/laws/sarc/sarcguidelines.html.

69 *Id*.

On January 28, 2011, Pearce briefed [redacted] and [redacted] on his meeting with **Bair**. ***"We have the green light for horizontal review if banks are unwilling to voluntarily exit due to debt indicator. Think the Chairman (and everyone else) would hope we can resolve this without the need to allocation [sic] of this level of resources."*** [redacted] replied that the review would be pushed back until after the [redacted] Board meeting, scheduled for February 14, 2011.

On February 3, 2011, [redacted] updated Pearce on the status of actions with respect to the three RAL banks. Then, on February 4, 2011, [redacted] sent details on the upcoming horizontal review, including the checklist of questions that would be asked at the EROs, to all the Regional Directors, copying [redacted] Pearce, [redacted] and others.

XX. Continued Efforts Toward a Written Agreement with [redacted]

At the end of January and into February 2011, [redacted] continued her efforts to settle with [redacted] as the horizontal review was being planned in parallel. This effort included continued consideration of a written agreement. On January 31, 2011, [redacted] wrote to [redacted] "we should separate the debt indicator piece from the rest of the exam and try to execute something like a written agreement to exit. Among the things that I don't know is whether the program is so bad that they should have to stop now to avert consumer harm." On February 1, 2011, [redacted] informed [redacted] "I have looked at the outstanding order and we would be agreeable to terminating the Order with Written Agreement from the bank to exit the RAL business." [redacted] also made clear in an email to [redacted] Lowe, [redacted] Pearce, and [redacted] copying [redacted] and others that they had all agreed that "we are not planning to go after any of [redacted] other tax related products if they agree to exit the RAL business."

[redacted] desire to be placed on the FDIC's bidders list of banks allowed to acquire failing institutions, as a part of any agreement to settle, remained an issue on the minds of FDIC personnel. [redacted] wrote to [redacted] Pearce, [redacted] and [redacted] copying [redacted] Lowe, and others that ***"…I would like to make sure everyone is on the same page with regard to the prerequisites for getting on the bid list. I think they should be explicitly spelled out. Lowe responded, "[a]gree with [redacted] – with this bank [redacted] let's be as transparent as possible on bid list qualifications. I would anticipate that immediately after executing the agreement, they will contact us as soon as the same day on accessing intralinks [the bidding system]."*** [redacted] took steps to that end on February 5, 2011. She revised a draft letter to [redacted] regarding RALs to deemphasize the link between [redacted] signing the Written Agreement to exit the RAL business and the bank being added to the FDIC's bidders list. Specifically, she told [redacted] Lowe, and others, via email, that "I've also fuzzied up the specifics regarding the bid list discussion…" She removed language that read, "[i]n addition, the FDIC committed to review the Bank's request to be added to the FDIC's bidder's list, subject to satisfaction of due diligence concerns, after the Bank had entered into the Written Agreement and exited the RAL business."

With the date of the horizontal review fast approaching, on February 7, 2011, [redacted] told [redacted], respectively, that the "ultimatum letter [was] sent to [redacted] this morning." She also stated that if there was no resolution with [redacted] "then we can issue the Notice as early as Wednesday." [redacted] replied, "[t]hanks for the heads up [redacted]." [redacted] relayed to colleagues that [redacted] letter to [redacted] "threatens [redacted] that if the WA [Written Agreement] is not signed by tomorrow, that we plan to issue the NOC."

XXI. The [redacted] Notice of Charges

According to meeting notes taken by [redacted] he met with [redacted] [redacted] [redacted] [redacted] [redacted] and others, on February 7, 2011, to discuss [redacted] and the other banks in RALs. [redacted] reflected in his notes that [redacted] reported that there would be a meeting with [redacted] at 4:00 p.m. that day. [redacted] also alerted the group that [redacted] had filed a SARC appeal of its August 30, 2010 S&S ROE. According to [redacted] notes, [redacted] then stated that the "Debt Indicator is mentioned in the ROE, but may not be a major focus" and "[i]n the review process, the [S&S examination] rating was changed."

[redacted] in his capacity as Chairman of the CRC, was briefed, later that day, by Legal and DSC on the proposed NOC against [redacted] and, following that meeting, Legal was authorized to file the NOC. According to [redacted] notes from that meeting, attendees included, [redacted] [redacted] [redacted] [redacted] Pearce, [redacted] and [redacted] Then, at 5:40 p.m., [redacted] emailed the CRC members, including [redacted] [redacted] and [redacted] copying [redacted] [redacted] [redacted] Lowe, [redacted] [redacted] [redacted], stating:

Please be advised that following an oral briefing of [CRC] [redacted] today by representatives of the Legal Division and The Division of Supervision and Consumer Protection, the Legal Division has been authorized to file a Notice of Charges against [redacted]… by Wednesday February 9, 2011 for unsafe and unsound banking practices in connection with the underwriting of Refund Anticipation Loans (RALs). Although a full briefing of the case will take place at the CRC meeting scheduled for February 17, 2011, [redacted] and [redacted] will be glad to brief you individually in advance of filing should you so desire.

[redacted] forwarded the email, later that evening, to **Bair**, copying **Eberley**.

According to the CRC's charter, the CRC is supposed to vote, under certain circumstances, in order to express its concurrence that a NOC go forward and be issued.[70] When we spoke to [redacted] as a part of this Inquiry, he explained that the [redacted] NOC did not need CRC approval because it did not include a CMP, removal action, or restitution. However,

[70] FDIC Board Resolution Seal No. 061427 as amended; FDIC Board Resolution Seal No. 074120 as amended.

enforcement actions that can be issued under delegated authority by management can be brought to the CRC.

FDIC Board Resolution Seal No. 07227, Section B "Functions and Duties The Case Review Committee Shall -" part (2) reads:

review in advance and approve the initiation under delegated authority of certain enforcement actions within the scope of the adopted Guidelines for Enforcement Actions Against Individuals (i) based upon a determination by the Director, Division of Supervision and Consumer Protection, or his designee, after consultation with the Legal Division, that a proposed enforcement action may affect Corporation policy, attract unusual attention or publicity, or involve an issue of first impression, and the Chairperson of the Committee determines that review and approval by the Committee would be desirable, or (ii) based upon a discretionary determination by the Chairperson of the Committee that such prior review and approval is desirable.

Given that the minutes of the February 17, 2011 CRC meeting reflect that [redacted] was discussed but no vote was taken to approve the NOC, it appears that [redacted], as CRC Chairman, did not formally refer the matter to the full CRC for a vote. [redacted] told our office that, in this instance, the reality was that the [redacted] NOC would not have gone forward if the Chairman of the CRC was not in favor of the NOC. [redacted] told us that the WO was clearly invested in the decision and even though the authority was delegated to the field.

Therefore, as discussed above at Section XV, [redacted] was a part of drafting the [redacted] Consent Order, that was ultimately voted on by the CRC which he chaired. Additionally, as discussed at Section XIII, he prompted staff to issue letters rejecting the RAL underwriting plan for [redacted] before the FDIC had completed its analysis of the plan. While [redacted] did not recall seeing or reviewing the analysis of [redacted] plan nor directing anyone to find the plan inadequate, when asked if he understood that the deficiency of the plan was a basis for going forward with the NOC, he replied that it was a critical factor, as the plan was a key part of underwriting. It appears [redacted] was then presented the NOC by management for his concurrence.

[redacted] told us he is "only a board member and does not dictate supervision tactics." [redacted] stated that he never directed supervisory or examination activity and if anyone felt he was giving direction, no one worked for him; that falls under the FDIC Chairman. [redacted] said he could not speculate on what anyone would do based on discussions he had with them. He stated that "telling people what to do is not my style."

XXII. The Final Push to Get [redacted] out of RALs

At the end of 2010 and beginning of 2011, the FDIC was also working to get [redacted] to abandon its RAL business. This effort was executed by the same FDIC personnel that had spurred the push against [redacted]

A. A [redacted] Consent Order Versus Written Agreement

On November 18, 2010, [redacted] sent Lowe and [redacted] a draft [redacted] Consent Order and provided a list of findings regarding the bank's lack of third-party oversight. Like the draft [redacted] Consent Order, the draft Consent Order for [redacted] instructed the bank to exit RALs and gave management 30 days to provide a Risk Management Plan for their RAL program that would be reviewed by Lowe for a determination about whether the bank could re-enter the business. As with the draft [redacted] Consent Order, the draft [redacted] Consent Order was vetted in the WO. On the same day Lowe received the draft from [redacted] he sent it to [redacted] for her review and approval of next steps. A more formal memorandum followed, on December 10, 2010, from [redacted] to [redacted] which requested consultation and concurrence on the proposed [redacted] Consent Order. A revised draft Consent Order was sent to [redacted] and [redacted] on January 5, 2011, for their review. [redacted] then sent the draft to [redacted] and Pearce, copying [redacted] [redacted] and others on January 31, 2011. That same day, [redacted] sent additional edits to the draft [redacted] Consent Order to [redacted] and others that "incorporated [redacted] suggestions." [redacted] forwarded it to Pearce and told him "I will get [redacted] approval and send to region in a.m." Then on February 2, 2011, [redacted] sent a copy of the [redacted] Consent Order to [redacted] and [redacted] with a note that stated that they were "directing them to submit a plan to exit the RAL business." [redacted] replied to [redacted] "Thanks."

On February 3, 2011, the FDIC delivered the proposed Consent Order to [redacted] Board that would have (among other things) required the institution to stop offering RALs. The proposed Consent Order was based on apparent significant weaknesses in the institution's oversight, control, and monitoring of third-party risk, particularly with respect to nontraditional products, and apparent violations of laws and/or regulations detailed in the May 15, 2009 Compliance ROE.

Though [redacted] reported, on February 10, 2011, that "[redacted] said he prefers to have a Consent Order," a Written Agreement was also drafted for [redacted]. [redacted] wrote to [redacted] copying [redacted] Pearce, [redacted] [redacted] about the [redacted] Written Agreement that day. "Is this something [redacted] and/or the **Chairman's Office** need to know about before it is finalized?" [redacted] responded to the group, "As to our **board members**, I would be happy to keep them informed, or someone else can. Just let me know. I believe that they were knowledgeable of the WA as a concept for [redacted] and thus would not be surprised by one for [redacted]." [redacted] then responded to all that "I concur with [redacted] comments and will ensure that [redacted] is informed."

B. The Release of Non-Public Information and Abusive Tactics as Leverage Toward Settlement

On February 9, 2011, [redacted] hired [redacted] as its counsel. Beginning that day, Supervisory Counsel in the Enforcement Section of WO Legal, [redacted], began interfacing with [redacted] about an exit from RALs by [redacted]. That day, [redacted] wrote to [redacted] and [redacted] that he told [redacted] “we need a signed binding exit document by Monday.” He also relayed to [redacted] what [redacted] [redacted] Pearce, and Lowe had all agreed upon – that they were willing to go forward with a one provision Consent Order on RALs and continue with other provisions later. This is significant because, as described above, [redacted] tax business accounted for [redacted] percent of its income. Therefore, [redacted] might be persuaded to give up a portion of its income from RALs in order to preserve the rest of its tax business.

On February 10, 2011, [redacted] told [redacted] via email, that if the bank executed a Written Agreement “we can call off the dogs (for now).” He forwarded the email to [redacted] [redacted] Pearce, [redacted] [redacted] [redacted] [redacted] [redacted] [redacted] and others. [redacted] responded to [redacted] copying [redacted] the next day; “[y]ou get a Platinum star i[f] you can pull this off!!!”

[redacted] wrote separately to [redacted] on February 10, 2011, to let him know that [redacted] had been hired by [redacted]. [redacted] replied to [redacted] [redacted] [redacted] and [redacted] “I’ve spoken to him already. They know what is expected or ‘else.’”

1. The Events of Friday February 11, 2011

February 11, 2011 was important in two ways; it was the Friday before the Monday meeting the FDIC had scheduled with [redacted] Board on the combined S&S and Compliance Consent Order and also the Friday before the Horizontal Review of any remaining RALs institutions that was slated for the upcoming Tuesday and Wednesday, February 15-16, 2011. It is clear that those from the FDIC who were involved in the effort to eradicate the bank’s RAL programs felt a heightened urgency to get [redacted] to settle, given the impending deadlines.

At 9:03 a.m.[71] [redacted] wrote to [redacted] and [redacted] that “[redacted] ***wants more muscle at the [[redacted] Board] meeting on Monday... I think one of you should consider going. She also wants me to go.”*** [redacted] agreed to attend. [redacted] ***reported at 11:36 a.m. that [redacted] was aware of the [redacted] Notice of Charges that had become public the previous day and that he told [redacted] via email, “something worse of an unspecified nature would be happening to them [[redacted]].”***

At 9:42 a.m. [redacted] suggested, in an email, that [redacted] attend the [redacted] Board meeting with [redacted] and [redacted] if no stipulation was achieved that day. [redacted] agreed. ***“I think it would***

[71] All times are provided in Eastern Standard Time.

help to have some very strong moral suasion." His second-line supervisor, [redacted] agreed to send [redacted] to the meeting. When interviewed as a part of this Inquiry, [redacted] told us that she thought sending [redacted] was the FDIC's last chance to push for a stipulation to avoid a NOC and limit horizontal review efforts.

At 10:26 a.m. [redacted] wrote to [redacted] (and later forwarded to [redacted] and [redacted] at 3:02 p.m.) that:

[the] [o]ther bank [[redacted]] has settled. Non-public as of yet. I am telling you to facilitate settlement, as I think it is material to your client's position. Yours will be the last one left. As we discussed, we think they are the outlier and weak one to begin with —and we plan to hit it with all its worth if we do not get a settlement immediately. I am not prepared to say what we are going to do, but it will be a substantial action from the part of the FDIC, and one that will require the weekend. This is why I am pushing for resolution today...

At 1:30 p.m. [redacted] wrote to [redacted] Lowe, [redacted] and [redacted] that ***"…Andy is fully aware that unspecified action will result if no answer. He… also asked about [redacted]. I did not provide non-public information, other than by stating that his client was now the last man standing, and that made his client a very attractive target, a target we were intending to take on immediately without agreement."***

At 4:20 p.m. [redacted] filed a Form 8-K with the SEC announcing its exit from RALs. "For the 2010 tax season, RAL fees totaled $655,000. Thus, the Bank's termination of this product will negatively affect our results of operations." This was [redacted] first public announcement that the bank would be exiting the RALs business.

At 8:13 p.m. [redacted] wrote to [redacted] ***"Andy, per our prior discussions, now public" with a link to an article reflecting that [redacted] was ceasing its RAL business line (the article was first published online at 5:54 p.m. EST).*** He continued, "[y]our client is the last remaining state nonmember. We intend to see the bank immediately indicate its willingness to exit, or we will be forced to move forward." [redacted] forwarded his email to [redacted] and Pearce saying "I told [redacted] his client was the last man standing. And we were not going to allow that to continue." He sent a similar email to [redacted] and others. [redacted] forwarded the chain to Pearce at 8:32 p.m. and wrote ***"I hope [redacted] doesn't get fired over this. I think he is so excited he is not seeking approval from above and [redacted] is very concerned."***[72]

[redacted] statement in his 1:30 p.m. email, that he had not provided [redacted] with non-public information, is false, as his 10:26 a.m. and 8:13 p.m. emails reflect. He had provided, in his own

[72] When interviewed, [redacted] stated that eventually everyone became concerned over [redacted] conduct, including [redacted] because [redacted] was saying things to [redacted] attorney that "we would not say to a bank." He was "fired up." She stated that she discussed her concerns with [redacted] before [redacted] went to the [redacted] Board meeting on February 14, 2011.

words, non-public information, to a competitor bank, through the bank's attorney, about [redacted], an institution whose Banc Corp's stock was publicly traded on the NASDAQ. [redacted] and [redacted] should have known this was a lie at 3:02 p.m. when [redacted] forwarded his 10:26 a.m. email to them.[73] [redacted] Pearce, and [redacted] all received [redacted] 8:13 p.m. email to [redacted] reflecting that a discussion of non-public matters must have occurred earlier between [redacted] and [redacted]

While these events were taking place, [redacted] wrote to [redacted], Lowe, [redacted] and others (and later forwarded to [redacted] and others) a synopsis of the exit meeting with [redacted] management regarding the October 25, 2010 S&S ROE. "There was no hint of an intention to leave the RAL business." She also stated, "[redacted] said they knew the FDIC's actions are politically motivated because some people find RALs distasteful." She further pointed out:

For this tax season, which is at its peak this week, they've had very limited loss. With $3.3 million loaned out, they only have $90,000 that are delinquent receipts. We may want to consider rephrasing some of the comments in the ROE related to the debt indicator. We were aware of this fact, but Mr. Monarch also repeated the point that the bank underwrote RALs in previous tax years without the debt indicator and incurred minimal losses.

a. Part 309 Violation[74]

Part 309 of the FDIC Rules and Regulations (12 C.F.R. 309) contains the FDIC's policies and procedures to ensure disclosure of information is in compliance with the Freedom of Information Act (FOIA) 5 U.S.C. 552 and the Right to Financial Privacy Act 12 U.S.C. 3401 et seq.[75] The general rule underlying FOIA is that government records should be publicly available. However, through nine statutory exemptions, FOIA recognizes that certain records may or should remain confidential and the FDIC has adopted these same nine exemptions in Section 309.5(g)(1-9).

Exemptions of particular relevance here are:

- Trade secrets and commercial or financial information obtained from a person that is privileged or confidential. § 309.5(g)(4); and
- Examination Related Records which are defined in Part 309 as "[a]ny. . .record contained in or related to the examination, operating or condition reports prepared by, on behalf of

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73 When asked during this Inquiry, [redacted] stated that it did not "register" with her at the time that [redacted] was providing [redacted] with non-public information.

74 http://fdic01.prod.fdic.gov/division/legal/supervision/Monographs/part309/introduction.html

75 The Right to Financial Privacy Act protects customer financial information from being transferred from one federal authority to another.

or for the use of the FDIC or any agency responsible for the regulation or supervision of financial institutions" are exempt from disclosure. § 309.5(g)(8).

The term "record" is defined in Section 309.2(e) to include records, files, documents, reports, correspondence, books, and accounts, or any portion thereof, in any form the FDIC regularly maintains them. Equally, Section 309.2(d) and (f) define "examination" and "report of examination" to include: examiner work papers, notes and knowledge as well as information regarding follow-up to examinations or cease and desist orders.

Disclosure of exempt records is prohibited (except under specific circumstances) and typically, according to Section 309.6:

No person shall disclose or permit the disclosure of any exempt records, or information contained therein, to any persons other than those officers, directors, employees, or agents of the Corporation who have a need for such records in the performance of their official duties. In any instance in which any person has possession, custody or control of FDIC exempt records or information contained therein, all copies of such records shall remain the property of the Corporation and under no circumstances shall any person, entity or agency disclose or make public in any manner the exempt records or information without written authorization from the Director of the Corporation's Division having primary authority over the records or information as provided in this section.

Based on the facts described above, [redacted] appears to have violated Part 309, and [redacted] Pearce, and [redacted] should have been aware of his actions. We did not find any evidence that [redacted] was counseled or disciplined for his disclosure of non-public information.

b. Potential Securities Law Violations

The nation's securities laws prohibit trading on insider, or non-public, information. Because non-public information was shared outside the FDIC about an insured institution whose holding company's stock was publicly traded, the OIG has referred this matter to the SEC and alerted the Department of Justice of this referral.

c. Potential State Bar Association Referrals

In light of [redacted] actions, as described above, the OIG has reached out to the State Bar Associations in the states where [redacted] is licensed. The OIG is seeking to determine whether formal ethics referrals to these Bar Associations, regarding [redacted] conduct, are appropriate.

2. February 14, 2011 [redacted] Board Meeting Regarding the May 15, 2009 Compliance Examination and Proposed Consent Order

On the morning of February 14, 2011, [redacted], emailed [redacted] to let him know that the bank's Board met the day before, on a Sunday, but did not make a decision about exiting RALs, so that day's scheduled meeting between the bank and the FDIC would need to proceed. [redacted] replied to [redacted] "[t]o prepare your clients, nothing less than a definitive agreement with them today will be needed to avoid further action." Despite [redacted] conduct on February 10-11, 2011, he continued acting as a representative of the FDIC with [redacted] and was sent, in that capacity, to the FDIC's meeting with the bank's Board on February 14, 2011, as discussed in detail below.

[redacted] and [redacted] discussed next steps if [redacted] decided not to stipulate to the Consent Order at the meeting. [redacted] wanted a NOC issued "…tonight or tomorrow, and amend later if necessary... consistent with [redacted] and the strategy…" [redacted] wanted to wait for the results of the horizontal review before issuing the NOC. She wrote to Lowe, copying [redacted] and [redacted] to convey [redacted] view. "[redacted] still wants to go ahead ASAP with the Notice on [redacted] if they don't stip." [redacted] replied just to [redacted] "[redacted] your job is to get a certain person [[redacted], [redacted]] on board with this. The rest of us are all in agreement." She replied, "[u]nderstood completely. Will work on it." He replied, "[t]hank you. We will 'gitter done.'" [redacted] told us that even though the Legal opinion from [redacted] at the time, was that the FDIC did not have enough to file a NOC against [redacted] DCP had a "keen belief" that the horizontal review would provide the ammunition necessary, and the thought was that it was worth a try on [redacted]. [redacted] said that "if you want to say we were bluffing, yes."

The FDIC met with [redacted] Board and some of its executives that afternoon to discuss the May 15, 2009 Compliance Examination results and the proposed Consent Order. The bank's counsel, [redacted] was also in attendance. FDIC representatives from RMS, DCP,[76] and Legal included [redacted], and [redacted]. [redacted] represented the [redacted] at the meeting. [redacted] created a summary of the meeting, which was loaded into RADD.

Once the results of the Compliance Examination were presented, [redacted] wrote that:

> [redacted] ***then began by stating that management at the FDIC in Washington would bring the full force of the Corporation to bear against the bank if the Board of Directors did not immediately agree to cease offering RALs at the end of the 2011 tax season. He said there would be immediate consequences, beginning the next day, unless the Board agreed to stop offering RALs.*** *When asked, FDIC attorney [redacted] did not answer why the immediate decision was necessary although the FDIC was aware that the bank had been offering RALs since 1988 with no detrimental effect on the bank or any customer. FDIC attorney [redacted] said that "nothing*

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[76] DSC was split into two divisions, effective February 13, 2011, – the Risk Management and Supervision Division (RMS) and Division of Depositor and Consumer Protection (DCP). The latter would be headed by Mark Pearce. [redacted] was named as [redacted]. This appears to indicate that the Chairman and the Board were satisfied with the performance of Pearce and [redacted]

is off the table" pertaining to actions the management of the FDIC would take. When asked by bank attorney [redacted] FDIC attorney [redacted] declined to state the actions FDIC management would take if the Board did not get out of the RAL business.

FDIC attorney [redacted] said FDIC Washington Management wants the bank out of the RAL business by the end of the tax year. If the Board agrees, the rest of the provisions delineated in the Compliance Report of Examination can be negotiated.

This is especially alarming because violations cited in the 2009 Compliance ROE were not limited to RALs, and included unfair re-pricing of adjustable rate mortgages and inaccurate good faith estimates. Potentially "negotiating" these away seems inconsistent with the stated goal of the FDIC with respect to limiting or eliminating RALs – consumer protection.

According to [redacted] the Board members left for about 20 minutes to discuss the situation with their attorneys. At 6:25 p.m. [redacted] emailed Lowe and [redacted] "[redacted] board is currently in Executive session discussing whether to sign Written Agreement." (The email was forwarded to [redacted] Pearce, [redacted], and [redacted]

[redacted] told us that, while the Board conferred, he made separate telephone calls to both [redacted] and Lowe. Afterwards, there was a conference call between [redacted] Lowe, and Pearce to discuss whether to pursue a Written Agreement or a Consent Order. Lowe was willing to take the deal, a Written Agreement, but [redacted] was reluctant. Pearce ultimately decided the Written Agreement was acceptable. [redacted] told us he felt that [redacted] presence helped convince [redacted] because she knew "her guy" was there.

[redacted] told us she received a call on her cell phone from [redacted] during the [redacted] meeting. He asked her "how hard we wanted to push to get the bank to sign the agreement" because he thought [redacted] was pushing too hard. [redacted] told her that he had never seen an attorney address a bank's Board the way [redacted] had and was curious if [redacted] was authorized or instructed to act the way that he did. [redacted] stated that she told [redacted] to get control of the meeting and that he was the primary representative for the FDIC. She stated that she told him not to force the bank to sign the agreement. [redacted] later told her that when he returned to the meeting, it had gone further downhill while he was gone.

When the Board returned, [redacted] reported:

Attorney [redacted] said 'Threats aside…' the bank 'will get out of the RAL business.' The meeting lasted about another two hours while [redacted] and the FDIC attorneys consulted with [redacted] in Washington, regarding the language in the resolution the bank Board would sign and the press release that the bank would place on its web page the following morning.

At the conclusion of the meeting, [redacted] *mentioned that* [redacted] *had said he was 'evil.'* [redacted] ***said he was only following orders from FDIC Washington management in his confrontational approach.*** [redacted] ***said that, although bank attorney*** [redacted] ***may have been operating under strict orders, the 'conduct was shameful' and 'no bank should be treated like that by their regulator.'***

During the two hours when FDIC personnel at the meeting were conferring with the WO, a number of emails and calls took place. At 7:24 p.m. [redacted] emailed Pearce, [redacted] and [redacted] copying Lowe and stated that [redacted] was offering to exit the RAL business and would continue to work on addressing issues with its other tax products. [redacted] wrote, "I think we are missing any opportunity to do the horizontal review and get the support we may need to do the order later."

Lowe proposed a conference call with [redacted] Pearce, [redacted] [redacted] and [redacted] for 7:50 p.m. because "I just talked with our folks at the bank, including [redacted], and the[y] strongly recommend pursuing an agreement along the lines of what is proposed by the bank." Both [redacted] and Pearce responded that they would call in.

At 7:48 p.m. [redacted] wrote to Pearce "Anthony [Lowe] and [redacted] called me separately. My recommendation was to require an order. Nothing less." A few minutes later [redacted] wrote, "[t]hat said, I defer to you." The next day he wrote to [redacted] and told her to "[d]elete this," referring to the email chain.

Then at 8:38 p.m., [redacted] emailed all the Regional Directors, copying [redacted] Pearce, [redacted] [redacted] [redacted] and others, subject line: "[redacted] – Cancelled." She wrote, "[t]he bank will issue a Press Release tomorrow morning stating that it will [e]xit the RAL business, so we will not do Horizontal Reviews. Please re-deploy your teams to [redacted] locations only." [redacted] forwarded the message to [redacted] "I'll tell you how this went tomorrow." At 8:50 p.m. [redacted] emailed a group, including [redacted] and [redacted] subject line: "Stand Down on [redacted] She wrote that, "[redacted] has agreed to a Board Resolution and a Press Release announcing that they will exit the RAL business after the 2011 tax season. As such, we do not need to do the visit or horizontal reviews at [redacted]."

Finally, at 9:24 p.m., [redacted] emailed [redacted] [redacted] and others that [redacted] would exit RALs at the end of the tax season. He added that the horizontal review of [redacted] had been called off but that it would proceed against [redacted] "[redacted] [redacted] Mark [Pearce] and [redacted] agreed with this approach."

As part of this Inquiry, we interviewed a number of people that attended the February 14, 2011 meeting with [redacted] to get their views on what transpired. [redacted] said the meeting was far worse than what was summarized in [redacted] memorandum. She said it was a "terrible, terrible meeting." She was shocked at how strong the message from the WO was to force the bank out of RALs. While [redacted] was not surprised at the WO's dislike of RALs, she was not prepared for the manner in which [redacted] expressed it. She believed that telling a bank to get out of a legitimate line of business was appalling and inappropriate. [redacted] said that she considered pulling out the guidance for whistleblowers after the meeting, but she knew the WO wanted the bank out of RALs, so she did not believe a complaint would go anywhere. She added that it was the only time she has ever asked herself if she wanted to continue working for the FDIC. She said that she has never been so ashamed in all her life to work for the FDIC. She believes the FDIC is a great organization, but this was shameful.

Others who attended the meeting echoed [redacted] comments. [redacted] recalled [redacted] using words like "bombs will drop" if [redacted] did not agree to exit RALs. [redacted] recalled the comment, but believed [redacted] had said there were "bombers in the air." [redacted] said [redacted] "went way over the top," so much so that she was embarrassed. [redacted] subsequently said "[redacted] got on his soap box and threatened the bank." He said that [redacted] made it very clear that if the bank exited RALs, everything else was negotiable. [redacted] said he had never been to a meeting where someone from the FDIC acted like [redacted] did. [redacted] told us [redacted] from [redacted], commented that [redacted] behavior was "the most abusive thing she had ever seen."

C. Praise for [redacted] Contribution

On February 15, 2011, the day after [redacted] conduct at the [redacted] Board meeting, he received praise for his performance. [redacted], [redacted] second level supervisor, wrote simply "Excellent!"[77] upon learning the news that [redacted] was exiting the RAL business. A number of his Legal colleagues also congratulated him on the settlement and called it a "Good result!" The clients were also satisfied. [redacted] wrote to [redacted] and [redacted] copying Lowe, [redacted] and [redacted] stating "I hope you all got a good night's rest after a very long and grueling session with the bank. Thanks for all your work on this." His supervisor, [redacted] also emailed [redacted] about his performance, on February 15, 2011, with respect to the horizontal review (discussed in more detail below), ***"you have really done a wonderful job for the FDIC, and that's what i[s] really important."***

When interviewed during this Inquiry, [redacted] stated that he counseled [redacted] on his behavior at the [redacted] Board meeting. [redacted] called it "no ordinary counseling" and said that before providing the counseling he talked to a wide range of people who were at the Board meeting. He also stated that he spoke with [redacted] and FDIC Human Resources personnel. [redacted] told us that he had discussed [redacted] behavior with [redacted] [redacted] said that [redacted] counseled [redacted] but he did not remember if it was a formal or informal counseling. [redacted] said

[77] When interviewed as a part of this Inquiry, [redacted] told us he was aware that [redacted] "misbehaved" at the February 14, 2011 exit meeting at [redacted] but he stated that he clearly did not hear about [redacted] behavior prior to him sending an e-mail saying that [redacted] actions to get [redacted] to an agreement to exit RALs was "Excellent!" [redacted] believed that he did, however, hear of [redacted] behavior within a short timeframe.

that he made it clear to [redacted] that any repeat of such behavior would result in formal disciplinary action. He stated that [redacted] promised not to conduct himself in that fashion in the future. The OIG was not able to uncover any written record of this counseling, a reprimand, or other negative feedback, with respect to [redacted] conduct at the [redacted] Board meeting. However, we were able to find a Mission Achievement Award given to [redacted] by [redacted] and [redacted] in December 2011 because "[redacted] ***had done a good job supervising his team this first year. He has done very good work on Consumer matters including his investigation plan for an extremely large matter involving a horizontal review of affiliates. In addition to this*** [redacted] ***has exhibited remarkable technical proficiency in banking and consumer law."*** The award included a monetary component of $1,350.[78]

D. [redacted] Announcement of its Exit from RALs

On February 15, 2011, [redacted] wrote to Lowe, [redacted] and [redacted] copying [redacted] and [redacted] expressing frustration that [redacted] had not yet issued a press release announcing its exit from RALs. "This is unacceptable and a breach of last night's agreement." She stated that if the bank did not issue the release by 9:00 a.m. the next day and alert its EROs, "we should issue the Notice ASAP." [redacted] forwarded the email to [redacted] on February 16, 2011 and wrote "[i]f you don't know what happened here, we can discuss today." [redacted] replied "[I] got a flavor for it from [redacted]" and he stated he would come and speak with [redacted] and [redacted] in her office. On February 16, 2011, [redacted] complied with the FDIC's demand and issued a press release entitled "[redacted] Bank Exits Refund Anticipation Loan Business." [redacted] stated that it had decided to exit the RAL business at the conclusion of the 2011 tax season following extensive conversations with its primary regulator, the FDIC, regarding its concerns about RALs.

XXIII. The Horizontal Review and the FDIC's Contemporaneous Interactions with [redacted]

On February 15-16, 2011, DCP and RMS commenced an unannounced visitation of [redacted] to review and analyze its RAL program and compliance with the outstanding February 2009 Cease and Desist Order. DCP and RMS also deployed approximately 400 examiners to conduct a 2-day horizontal review of 250 of [redacted] ERO providers in 36 states. At the time of the horizontal review, [redacted] and [redacted] had agreed to exit RALs at the end of the upcoming tax season. Despite the two banks' exits not being immediate, the FDIC decided to abandon planned horizontal reviews of those institutions and their EROs and only went forward against [redacted] who had not agreed to exit the RAL business.

The stated purpose of the horizontal review was to determine whether the EROs were complying with federal and state laws and regulations pertaining to the origination of RALs. RMS and DCP

[78] We looked to see if [redacted] received a year-end performance appraisal. He did not, due to his short tenure at the FDIC.

officials informed us that the number of EROs reviewed was large because a statistically valid sample was needed to support any supervisory actions that may have been warranted based on the outcome of the review. What is certain, is this was an unprecedented use of resources on a horizontal review, affecting a single bank, during the aftermath of the financial crisis, in a year where 92 other banks failed.

As described throughout this report, then-Chairman **Bair**, then-Vice Chairman **Gruenberg**, and [redacted] were all kept informed about progress toward effectuating the exit from the business line of the remaining institutions with RAL programs. This was as true during the lead up to the planned horizontal review, as it was at other junctures.[79] On February 9, 2011, [redacted] informed [redacted] **Gruenberg**, [redacted] [redacted] Pearce, and [redacted] that the [redacted] NOC would be posted on the FDIC's Website in late March; [redacted] had agreed to exit the RAL business; and [redacted] was considering exiting. [redacted] also sent this information to **Eberley** so she could notify **Bair**. **Eberley** had questions for [redacted] on February 10, 2011, about the status of the three RAL banks so she could "give the **Chairman** a heads up." He summarized the status of each and stated that "[a]ny bank that exits will no longer [be] subject to the horizontal review."

When interviewed by our office, [redacted] agreed that the effort taken to get these three banks out of the RALs business was enormous and more than was typical because of the interest in the business line "all the way up the food chain." [redacted] believed the heightened interest was due to the perception by staff that people at the highest levels wanted the banks out of RALs. [redacted] said it was obvious to him that [redacted] thought that was what he was supposed to do and [redacted] did not believe getting the banks to exit RALs was [redacted] idea. [redacted] said that those "running the show" were not after these particular banks, but the RAL product itself.

On February 15, 2011, [redacted] wrote to [redacted] copying **Bair** and [redacted] and accused the FDIC of using the horizontal review as a form of retaliation for the bank's choice to enter the administrative law process rather than settle. Pearce emailed [redacted] and [redacted] and instructed [redacted] to draft a short response rebutting the allegation of retaliation. He wrote, "[o]ur review of multiple banks offering tax products led us to develop the horizontal review of all banks engaging in the RAL business, and it only feels like retaliation b/c the other banks decided to exit the business based on concerns regarding the debt indicator." [redacted] responded to [redacted], copying Pearce to "strongly disagree" with [redacted] characterization of the FDIC's examination oversight. [redacted] responded, ***"[o]bviously, you and the FDIC weren't too concerned about the safety and soundness of our RAL product this year since the FDIC sought our agreement to exit the business next year. Just today*** [redacted]

[79] When interviewed as a part of this Inquiry, [redacted] told us he was briefed, as a [redacted], on a periodic basis by FDIC Division Directors. In particular, he noted he met on a regular basis with [redacted] and [redacted] on RALs. **Gruenberg** told us that he has received bi-weekly briefings from both risk management and compliance personnel from the time he was [redacted] through to the present.

[redacted] ***[sic] advised our counsel that this would go away if we signed the agreed order to exit the RAL business next year.”*** [redacted] emailed [redacted]. “This is unbelievable. I will probably be sued before it’s over. Please do not distribute further.”

[redacted] was referencing a phone call that took place between [redacted] and [redacted] counsel on February 15, 2011, in the presence of [redacted] and [redacted] in [redacted] office. On February 16, 2011, [redacted] sent a letter to [redacted] and copied the FDIC **Board**,[80] about [redacted] conduct on the phone with [redacted] counsel, the bank’s appeal of the August 30, 2010 S&S examination, and the horizontal review.

First, with respect to the conversation between [redacted] counsel and [redacted] [redacted] ***reported that*** [redacted] ***had said that “the surprise visitation would end if the Bank immediately entered into a Written Agreement to exit the RAL business. He also stated that the situation would ‘get a lot worse before it gets better.’”***

[redacted] wrote to [redacted] copying [redacted] on February 16, 2011. “I took [redacted] out of the [horizontal review] war room but explained attys sometimes have to let examiners do their thing, and that you were both. [*sic*] [h]appy with his remarkable work. Please do not mention to [redacted]].” [redacted] replied to all, “[redacted] has written a letter to all the FDIC board members naming [redacted] and [*sic*] inappropriately talking to the bank’s attorney and threatening them. We will need a statement from [redacted] about what he said. I think [redacted] will have to know because this has moved too high up the chain. Please advise if you want to tell [redacted] or you want [redacted] and I to do it.” [redacted] responded to all,” I would suggest that you get to [redacted] before he hears about it from someone else.”

On February 16, 2011, [redacted] drafted a response to the allegations in [redacted] letter and sent it to [redacted] and [redacted] [redacted] and [redacted] both reviewed the summary that day to which [redacted] made edits. In pertinent part [redacted] wrote:

She [[redacted] *attorney] then asked if the ‘FDIC would go away’ if* [redacted] *just signed the written agreement offered to* [redacted] *last week by* [redacted] [redacted] *and* [redacted] [redacted]. *I said probably not, since the horizontal examination had already begun and was in process, and that based on anecdotal results so far I suspected that ‘things were going to get worse before they get better,’ because we were finding substantial compliance violations of law and regulation.*

[80] When interviewed by our office, **Gruenberg** stated he did not recall receiving the letter from [redacted]. [redacted] told us that he may have heard about [redacted] conduct after the fact. [redacted] stated that although he was copied on the letter the bank sent to the FDIC Board members, the FDIC is “Chairman centric” and all letters go to the Chairman’s office for response. [redacted] further stated that [redacted] had a supervisor who would be responsible for any disciplinary action taken.

[redacted] advised [redacted] "[redacted] letter says (based on second hand information) you said we would stop the visitation if they agreed to exit. You are saying you said 'probably not.' I think [redacted] recalls you initially saying that you thought it would, but then essentially correcting yourself and saying it was not clear that it would." [redacted] did not change the language and sent his final summary of the events to [redacted] and [redacted] on the morning of February 17, 2011. He wrote, ***"[w]ell, now you have it. The witness who sat to my right during the call [redacted] has also reviewed it and concurs that this was the conversation that we had. Unfortunately for the bank (and bank counsel), there were half a dozen folks in the room, and all heard what I said (and did not say)."***

Pearce sent a memorandum to **Bair**, copying [redacted] and [redacted] about [redacted] letter on February 17, 2011. ***"I am troubled by the allegations made by [redacted] that our examiners and legal counsel made threats against the bank. We are looking into these allegations, but have no reason to believe FDIC staff made threatening statements. I have also been advised by Legal that the letter misrepresents [redacted] conversation…"***

When interviewed as part of this Inquiry, Pearce stated he first heard about [redacted] conduct at the [redacted] Board meeting several months later when [redacted] filed its appeal of its examination ratings with the SARC, through its attorney, [redacted] He stated he did not know about [redacted] conduct when he replied to **Bair** on February 17, 2011, regarding [redacted] allegations of mistreatment by [redacted] in a telephone conversation. Pearce said that he spoke with [redacted] and [redacted] and they both said that the letter from [redacted] [redacted] was not accurate with respect to what [redacted] said to [redacted] attorney. After initially hearing about [redacted] behavior the night of the [redacted] Board meeting from [redacted] (as described above), [redacted] said that she heard more fully about [redacted] behavior, and the language he used, from [redacted] within about a week. She recalled that she spoke with both Pearce and [redacted] about what [redacted] told her, but could not recall specifically when she spoke with them.

[redacted] also recalled that [redacted] was in her office on his cellphone with [redacted] attorney on February 15, 2011, during the horizontal review. ***She heard [redacted] talking and noticed that he got loud.*** [redacted] who was present, asked [redacted] who he was talking to and he replied that it was [redacted] attorney. [redacted] stated that she was not part of the discussion and does not recall what [redacted] said.

[redacted] ***told us that he did not remember the content of [redacted] conversation with [redacted] attorney but he did not believe it was good strategy for [redacted] to be in a screaming match with bank counsel. He added that there should be some flavor in the response that [redacted] was also loud mouthed. He added that if [redacted] did not include some of that flavor then he should have. Neither the submission by [redacted] edited by [redacted] about the phone call nor the memo from Pearce to Bair made any reference to [redacted] raising his voice with [redacted] attorney.***

[redacted] also told us that she, [redacted] and Legal composed the February 17, 2011, memorandum from Pearce to the Chairman. [redacted] agreed with Pearce's approach and she thought it was an appropriate response. She stated that "you do not let a bank accuse you of retaliation." It seems implausible given that [redacted] (1) reported to Pearce; (2) was aware of [redacted] conduct at the [redacted] Board meeting; (3) was present when [redacted] "got loud" on the phone with [redacted] attorney; and (4) assisted Pearce with drafting the memorandum to the **Chairman** about [redacted] phone call with [redacted] among other issues, that [redacted] would not have relayed the nature of [redacted] behavior to Pearce. Equally, at the time, Pearce, [redacted] and [redacted] had all received emails, on February 10-11, 2011, in which [redacted] said things to [redacted] attorney that "we [the FDIC] would not say to a bank" and used non-public information in an attempt to leverage a settlement with [redacted] yet none of this information was included in the memorandum to **Bair**.

In addition to [redacted] conduct, the other issues raised in [redacted] February 15, 2011 letter and February 16, 2011 email to Lowe, copying **Bair**, [redacted] and **Gruenberg** included [redacted] appeal of the [redacted] composite rating of the bank's August 30, 2010, S&S examination and the horizontal review. In the February 16, 2011, email, [redacted] explained that [redacted] had not received the FDIC's letter, dated February 10, 2011, denying its appeal until Lowe attached it in an email that day. [redacted] wrote, in part:

The letter we haven't received summarily denying our appeal concludes that 'the Bank's right to appeal was terminated when the FDIC provided written notice to the Bank indicating it's [sic] intention to pursue formal enforcement against the Bank.' ***It is baffling why the FDIC, on January 28th, would encourage and grant us an extension to file the appeal until March 30th if our right to appeal had already terminated.***

I would note that two other banks have recently succumbed to FDIC pressure to exit the RAL business in 2012 but will continue the business for the remainder of this tax season so the concern with regard to the safety and soundness of this product for this tax season seems tempered. *We remain one of the best capitalized, highest performing and most community minded banks in the country so it is hard to imagine the lengths the FDIC will go to legislate against this product.*

Bair forwarded [redacted] email to [redacted] and Pearce and wrote, "I don't understand???" [redacted] replied,

[redacted] *seems to be complaining that the bank has not yet received our response to his appeal. We heard the same from him today, and in response Anthony Lowe called him and provided the letter. Apparently the time interval was because the letter is in the mail. The substance of the matter is that we told the bank that it cannot appeal a matter that is the subject of a written notice of proposed enforcement action.*

This response did not address why [redacted] had been granted an extension by [redacted] to lodge its appeal if its appeal right had already been extinguished by the notice of the proposed enforcement action. In fact, [redacted] had written to [redacted] on January 28, 2011, "[w]ith respect to your appeal, if you will forward a written request for extension of time to file the appeal to [redacted] and to me, I will ensure that your extension request is processed by COB today. We're drafting the extension for 60 days, and you can request a second extension if necessary." During this Inquiry, the FDIC represented to us that it granted the extension because it cannot be known with certainty whether an issue is truly appealable until the bank submits the appeal.

XXIV. [redacted] Sues the FDIC

On March 1, 2011, [redacted] sued the FDIC, **Bair**, Lowe, and [redacted][81] [redacted] sent a news article about the suit to **Bair** that day. [redacted] brought the action:

…pursuant to the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 701 et seq., to require that Defendant Federal Deposit Insurance Corporation and the individual defendants in their official capacities (collectively, "FDIC") play by the rules. As set forth below, FDIC has apparently decided to force all lenders out of the business of making Refund Anticipation Loans ("RALs"), a lawful product that permits taxpayers to borrow against their future tax refunds. This suit seeks to require that any rule against RALs be created only through formal regulatory procedures, out in the open and subject to public comments, scrutiny and criticism, rather than through examinations and enforcement actions. Separately, this lawsuit seeks to require that FDIC not attempt to circumvent the rules governing a pending adjudicative proceeding involving [redacted] *RAL lending by use of its power of "examination" to conduct one-sided discovery for that proceeding, in derogation of APA requirements and* [redacted] *rights.*

After filing the lawsuit, [redacted] was in the news. On March 7, 2011, [redacted] emailed **Bair**, copying [redacted] and attaching a news article on [redacted] [redacted] wrote, "FYI - The following article on [redacted] was published by [redacted] this afternoon. [redacted] claims that [redacted] loss rate on RALs is [redacted] percent, which is considerably lower than the [redacted] percent charge-off rate on mortgage loans and credit card loans." The article also indicated that [redacted] shares had dropped by [redacted] percent, to date, in 2011.

XXV. The Amended Notice of Charges Against [redacted] and Its Inaccuracies and Weaknesses

On April 20, 2011, an FDIC staff attorney sent [redacted] Pearce, [redacted] and [redacted] copying [redacted], the modified CRC Memorandum on the

[81] [redacted], case number [redacted], U.S. District Court for the [redacted] ([redacted]).

Amended Notice of Charges (Amended Notice) and recommendation for a $2,000,000 CMP for [redacted].[82] On April 27, 2011, [redacted] sent **Bair**, copying [redacted] the draft Amended Notice. The FDIC issued the Amended Notice for an Order to Cease and Desist; Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law; Order to Pay; and Notice of Hearing to [redacted] on May 3, 2011. The Amended Notice alleged that the bank was engaging in an unsafe or unsound banking practice with respect to its RAL program and added Truth in Lending Violations (TILA), additional third-party risk control problems, failure to safeguard consumer personally identifiable information, cash and cash equivalents, violation of the Equal Credit Opportunity Act (ECOA) (spousal signature issue), UDAP with respect to marketing materials, providing of Frequently Asked Questions to their EROs to prepare them for examiner questions, and issues with their Currency Connection Program. The Amended Notice "…seek[s] to require the Bank to withdraw from participation in non-traditional lending and depository transactions including but not limited to RALs involving third-party providers processed through the TRS division."

On May 5, 2011, [redacted] alerted **Bair** to a [redacted] press release which he attached to his email. "FYI – [redacted] just issued the following press release today claiming that the RAL default rate for the current tax season is only [redacted] percent and the bank's RAL underwriting model has performed as designed for the 16th consecutive year, and with a much lower default rate than many other forms of traditional consumer credit." Pearce also wrote to **Bair**, copying [redacted] with talking points and the Amended Notice for [redacted] Then on May 9, 2011, Pearce emailed **Bair** "FYI, consumer groups (CFA [Consumer Federation of America] and NCLC [National Consumer Law Center]) picked up on [redacted] action and issued press release." **Bair** responded, "[t]hat's great. Glad to see your hard work being recognized."

Meanwhile, following the issuance of the Amended Notice, [redacted] sent a memorandum to [redacted] advising him "of weaknesses CRO [[redacted] Regional Office] believes exist in the Amended Notice. A small number of allegations may need to be abandoned altogether while others remain vulnerable to a Motion for Summary Disposition." In particular he noted:

Facts arising since the filing of the Amended Notice, including interviews with examiners and preliminary reviews of [redacted] RAL underwriting model reveal that the underwriting model actually alleviates [redacted] risk of loss*… During the Visitation [Horizontal Review], examiners reviewed the model which had been prepared by an outside consultant. Examiners voiced opinions that the underwriting model addresses the deficiency caused by the elimination of the debt indicator, i.e. it predicts whether a taxpayer is or is not going to get a tax refund. The modeling documentation was also provided to The [FDIC's] Division of Insurance and Research*

[82] As with the CMP recommendation to the CRC with [redacted] Consent Order (see Section XV above), staff basically doubled the amount generated through the use of the matrix. In this instance, the derived amount was $1,057,208. However, staff recommended, and the CRC approved, $2,000,000.

('DIR'). DIR's preliminary conclusion is that [redacted] *model appropriately measures risk based upon the likelihood that the taxpayer/borrower would receive a refund.*

Furthermore, the effectiveness of the underwriting model has been confirmed in practice as [redacted] ***default rate on RALs during the 2011 tax season was well within its projections. At the end of the 2011 tax season,*** [redacted] ***default rate was approximately 1.41%****. The Bank had budgeted for a default rate of 2.50%...*

These statements contradict the conclusion previously drawn by the FDIC, conveyed to the bank, and discussed above at Section XIII, about [redacted] RAL underwriting model.

[redacted] went on to explain that the FDIC's "TILA claim regarding record retention should be withdrawn" because the FDIC had alleged in the Amended Notice that [redacted] failed to meet a requirement that was not in fact required under TILA. He cited vulnerabilities to the FDIC's ECOA and Regulation B claims. Finally, he stated that allegations that [redacted] was in violation of its 2009 Cease and Desist Order with the FDIC were inaccurate.

In the afternoon on October 6, 2011, [redacted] sent an email, subject: "CRO bullet memo from yesterday" to five attorneys, assigning them the task of rebutting each point raised by [redacted] by the next morning. An initial response was circulated to the group by [redacted], [redacted], that evening and he sent a slightly longer version to [redacted] and [redacted] on October 11, 2011.

As described below at Section XXX, FDIC settled the case with [redacted] based on the Amended Notice which had not been changed to reflect [redacted] advice.

XXVI. Additional Congressional Interest

On March 16, 2011, **Bair** sent a letter to Congressman Ben Chandler in response to his letter regarding [redacted] and its RAL program. She explained, ***"…the FDIC has not made any policy decisions to prohibit RAL programs or issued supervisory policies that address RAL programs specifically…"*** She also continued, "[y]ou mention in your letter that the Bank's RAL program will be profitable in 2011 and ask whether such profitability proves the Bank's underwriting process is appropriate. While we cannot comment on the specifics related to our supervision or review of the Bank's underwriting of RALs, there are examples, some recent, that indicate that point-in-time profits are not a good indicator of sound underwriting. A case in point are subprime mortgage lenders that initially reported profits only to subsequently collapse when their poor underwriting resulted in heavy losses."

Following **Bair's** departure from the FDIC on July 8, 2011, [redacted] emailed the then-Acting Chairman **Gruenberg** and his [redacted] on August 31, 2011, attaching "**Sheila's** response on [redacted] The question came in after her final hearing on June 30 and the responses were signed by me on July 29." ***Senator Shelby had asked, "…the American Banker, published an article that detailed allegations that the FDIC improperly used its administrative powers when it conducted an unscheduled examination in retaliation for the bank's refusal to comply with an FDIC enforcement order…Were you aware of the decision to initiate the enforcement action detailed in the American Banker article and if so, did you authorize the enforcement action?"*** The FDIC's response did not address the question citing "confidential supervisory and law enforcement information concerning an individual depository institution, which institution is currently the subject of a pending administrative enforcement action…" As explained earlier in this report, **Bair** was aware of the plans for the horizontal review and, according to Pearce, had 'green lighted' it. [redacted] had also forwarded an email he received from Pearce to then-Acting Chairman **Gruenberg** and [redacted] on August 29, 2011, subject "[redacted] timeline." The email read, in part, "[o]ur horizontal review of RAL providers (including a visitation to [redacted]) occurred on 2/15/11. It was reported in an American Banker article on [redacted], after [redacted] filed a lawsuit in district court [against the FDIC]. We amended our Notice of Charges on 5/3/11, reflecting the results of the visitation."

XXVII. The [redacted] Consent Order

Though [redacted] had agreed to exit RALs, the FDIC was still interested in getting the bank out of its other tax products. On February 17, 2011, [redacted] wrote to [redacted] and [redacted] copying [redacted], and Lowe, "3 weeks and 4 days [un]til I get my Order with all tax products." Then on March 5, 2011, [redacted] wrote to [redacted] that she had told Lowe she wanted to present a [redacted] Consent Order at the March 17, 2011 CRC meeting, but Lowe had given the bank until March 18, 2011 to provide a response to the issues. "I can't think of anything that would change my mind so why wait. I may have gone crazy on this one but don't tell me until it's done." [redacted] was still pushing to make the March CRC meeting on March 10, 2011. [redacted] told her, that day, that it was not possible because of competing commitments, including work regarding the [redacted] lawsuit against the **Chairman**, Lowe, and [redacted] [redacted] told [redacted] that they could have a Consent Order ready for the April 13, 2011, CRC meeting. [redacted] replied, "We will distribute this case on Monday with or without an order."

On March 13, 2011, [redacted] sent [redacted] copying [redacted], a Draft CRC Memorandum on [redacted]. [redacted] relayed to [redacted] that the draft had gone to Pearce and told him to provide changes, if he had any. "This memorandum requests authorization to accept a stipulated Consent Order, as well as pursue an Order of Restitution and an Order to Pay a Civil Money Penalty… in the range of $145,000 to $160,000… Further, it specifically prohibits the Bank's participation in transactions with third-party providers of non-traditional products and requires the cessation of RAL or other non-traditional lending by April 15, 2011."

The Consent Order for [redacted] was presented at the March CRC meeting. On April 1, 2011, [redacted] **Bair's** representative on the CRC wrote to her, copying [redacted]

[redacted] is the case from the last Case Review Committee that I mentioned to you about two weeks ago. This bank also has a RAL program. The last compliance exam, which started on May 15, 2009, identified some UDAP and TILA issues and insufficient third party oversight. As a result, the bank's compliance rating was downgraded to '[redacted]' and the CRA rating was downgraded to 'Needs to Improve.' While I have concerns about the protracted time frame for completion of the compliance & CRA exams (nearly two years), my biggest concern involves the CAMELS ratings assigned at the last safety & soundness examination: [redacted]. According to the [redacted] Regional office, the [redacted] rating for the management component as well as the overall composite [redacted] rating for Safety & Soundness 'is based on the bank's poor compliance posture and the various risks associated with non-traditional bank products.' While I recognize the management component should factor in the bank's compliance rating, I have yet to see a double-downgrade of the bank's composite safety & soundness rating. I asked [redacted] ([redacted]) at the CRC meeting if they could provide other examples of similar downgrades and they could not think of any. Apparently, they have not been able to find any similar scenarios in the two weeks that have transpired since the last CRC meeting. ***The overall double downgrade for safety & soundness is highly unusual and inconsistent with our policy and past practice. I think the safety & soundness rating is overly harsh and indefensible, particularly considering the bank's assigned capital and asset quality ratings of [redacted] and [redacted] respectively, and also considering the bank's previous (2009) CAMELS rating of [redacted]***

Bair responded to [redacted] "No. That doesn't sound right." [redacted] replied, "[o]f course, the [redacted] rating for S&S means much higher deposit insurance assessment for the bank."

[redacted] provided **Bair** with additional specifics on April 5, 2011, ***"…the overall downgrade from a [redacted] to a [redacted] rating for safety & soundness results in a four-fold increase in the bank's assessment – from [redacted] per quarter to [redacted] per quarter."*** **Bair** forwarded her discussion with [redacted] to Pearce. ***"This is a pretty big wallop with no precedent. May well be justified. Your call. Just make sure everyone has thought it through."*** Pearce responded that since it was a S&S question, he had talked to [redacted] who would respond to **Bair**. We searched for, but did not find, an additional written response from either [redacted] or Pearce to **Bair** on this issue.

When we interviewed [redacted] he recalled being in the CRC meeting, sometime prior to April 1, 2011, when the [redacted] case was presented. At the meeting, he asked [redacted] about the composite rating being downgraded from a [redacted] to a [redacted] and recalled that she was "livid" that he was questioning the double downgrade in the composite rating based on compliance. In his mind, it was indefensible and highly unusual. He asked [redacted] if she could provide examples of any similar situations and she could not provide any. After that meeting, they rarely spoke. [redacted] opined that the double downgrade seemed "petty, vindictive, and unprecedented."

XXVIII. [redacted] Appeals of Its May 15, 2009, Compliance and October 25, 2010, S&S Examinations

On April 11, 2011, [redacted] Board met with the FDIC. The official account of the meeting in the FDIC's RADD system reflects that "[t]he Board disagree[d] with the findings of the May 15, 2009, Compliance examination and those findings were the major reasons management was rated a '4' and the composite rating for the bank was a [redacted] in the Safety and Soundness Report of Examination…" Later the memorandum states, "[t]he Board also noted that there appeared to be 'ulterior motives' behind the severity of the Compliance findings..."

On April 25, 2011, [redacted] requested a review of material supervisory determinations relating to the Compliance Examination dated May 15, 2009. This was the bank's first line appeal to the [redacted] Through their attorneys, including [redacted] they addressed a number of issues, including the meeting that took place on February 14, 2011, in its written appeal including:

The FDIC directed the Board to hold a meeting with the FDIC on February 14, 2011. In the days leading up to this meeting, [redacted] *became directly involved in communications with the Bank and its counsel.* [redacted] *repeatedly threatened in calls with counsel for the Bank that there would be 'serious consequences' if the Bank did not agree to exit the RAL business in advance of the meeting.* [redacted] *further made clear to the Bank's counsel that the Bank's decision to exit RAL lending or proceed with its RAL business would substantially impact the FDIC's decision whether to pursue formal enforcement proceedings related to the alleged violations enumerated in the Report. The Bank's counsel repeatedly informed* [redacted] *that the Board wished to hear the presentation of FDIC personnel at the February 14 meeting before making specific commitments.*

At the outset of the February 14 meeting, [redacted] *indicated to the Board that it was 'extremely rare' for Washington counsel to attend such a meeting. He advised that he was present because the Bank's RAL business had attracted attention and antipathy at the highest level of the FDIC…*

[redacted] ***repeatedly threatened the Bank with aggressive language, asserting that the FDIC was on the verge of 'going to war' with the Bank. He stated that unless the Bank agreed immediately to exit the RAL business, 'bombers' would be deployed, the Bank would face unprecedented and aggressive regulatory action as early as the next morning, and the Bank would be 'change[d] forever.'*** *Counsel for the Bank several times asked* [redacted] *to explain what he meant, and indicated that it was not possible adequately to advise the Bank's Board without an understanding of what the references to 'bombers in the air' and the threat of 'unprecedented' action meant.* [redacted] *refused to provide any details and stated that he was* *forbidden to elaborate.*[83] *Instead,* [redacted] *asserted that regulatory action would be 'entirely unexpected by you and your counsel' and would be 'imaginative and extremely aggressive.'* [redacted] ***also stated that the FDIC would not be concerned if a 'piss ant, $200 million bank failed.' He also noted that his 'boss,' the Senior Deputy Director for Compliance and CRA Examinations, was displeased with him because he was not being tough enough. The conduct of*** [redacted] ***at the meeting was shockingly unprofessional in a way never before experienced by the Board, its counsel, or the*** [redacted] ***Department of Financial Institutions representative present at the meeting.*** *Ultimately the meeting ended without the Board signing an Order, but instead issuing a resolution that the Bank would exit the RAL business at the conclusion of the tax season.*

Additionally, on May 27, 2011, the bank offered a "Submission to the Federal Deposit Insurance Corporation on Behalf of [redacted] contesting the October 25, 2010 Safety and Soundness Report of Examination." [redacted] denied [redacted] request on June 10, 2011.

On June 6, 2011, [redacted] Appeal regarding the May 15, 2009 Compliance Examination was denied at the Division level. Therefore, on June 17, 2011, [redacted] exercised its option to appeal the Division-level decision to the SARC.

Pursuant to the FDIC's appeal process, material determinations of examination findings cannot be appealed once "A formal enforcement-related action or decision commences, and… when the FDIC initiates a formal investigation under 12 U.S.C. 1820(c) or provides written notice to the bank indicating its intention to pursue available formal enforcement remedies…"[84] Equally, Subpart R of the FDIC's Guidelines for Appeals of Material Supervisory Determinations reads: "Effect on Supervisory or Enforcement Actions – The use of the procedures set forth in these guidelines by any institution will not affect, delay, or impede any formal or informal supervisory or enforcement action in progress or affect the FDIC's authority to take any supervisory or enforcement action against that institution."[85]

On July 13, 2011, [redacted] emailed [redacted] and [redacted] copying Pearce with an attached proposed Notice of Charges against [redacted] and alerted them that "[w]e are preparing [the] letter now to deny the bank's request for a SARC Appeal." The filing of the NOC would terminate [redacted] appeal rights.

On July 26, 2011, [redacted] emailed [redacted] the [redacted], copying [redacted] [redacted] [redacted] [redacted] [redacted], and

[83] "In light of [redacted] [redacted] February 28, 2011 federal complaint against the FDIC, it is apparent that [redacted] was referring to the deployment of the Agency's examination and subpoena powers." (footnote original to [redacted] Appeal)

[84] https://www.fdic.gov/regulations/laws/sarc/sarc.pdf

[85] https://www.fdic.gov/regulations/laws/sarc/sarcguidelines.html

others, attaching letters from DCP and RMS denying [redacted] SARC appeals. He also attached [redacted] DCP and RMS appeals that he stated were previously circulated on June 20, 2011. [redacted] forwarded the email to Pearce on July 30, 2011, saying the "[A]cting **Chairman** had not yet signed these letters," though the letters were drafted for signature by the Executive Secretary. Regardless, this reflects that, the then-**Acting Chairman's** office had the information put forth by [redacted] in its appeals, including information about [redacted] conduct. When we interviewed Chairman **Gruenberg**, he stated that he did not recall reading [redacted] appeal, never met [redacted] and had never heard of him prior to this Inquiry. The FDIC further represented to our office that [redacted] did not acknowledge the July 26, 2011 email, print or read its contents, or forward it to **Gruenberg**.

Pearce also told us that, in August 2011, he traveled to [redacted] to meet with [redacted] executives and some of its Board members regarding the way they were treated by [redacted] at the February Board meeting. He did not want the bankers to feel that the FDIC deemed their treatment acceptable. He told us he expects bankers to be treated professionally and the FDIC did not meet that standard with [redacted].

[redacted] left the FDIC, of his own accord, in December 2011 to take the Assistant Inspector General of Investigations position at the SEC's OIG. He began work there on January 4, 2012. As described above, some at the FDIC knew of [redacted] conduct toward [redacted] contemporaneously with his interactions with the bank, some found out soon afterward, and no later than July 2011, five months before [redacted] left the FDIC, the highest levels of leadership should have known of his behavior yet no documented action was taken in response to his conduct and as discussed above, he received an award for his performance.

XXIX. An About Face on [redacted] [redacted]

Between September 2011 and November 2011, the FDIC changed its position on [redacted]. As described previously, the [redacted] was a direct-deposit product marketed to money service businesses such as check cashers and pawn shops. These businesses market the product to target individuals that do not participate in the banking system. The program provides check issuance and a debit card. On September 13-14, 2011, an email conversation occurred between Lowe, [redacted] and Pearce. Initially, Lowe wrote to [redacted] copying Pearce, "[d]uring the call with [redacted] on [sic] yesterday, we advised of no change in our position relative to the [redacted], and that the bank should make plans to exit… [redacted] ***[[redacted] attorney] then advised, during the discussion of the CMP, that the bank would be willing to pay a fine of up to $100 thousand if allowed to remain in the [redacted]. However, [redacted] indicated he would likely advise the bank to refrain from agreeing to a fine absent continuation of the program***…" The next day Pearce replied, "I don't think the CMP and [redacted] are connected in anyway." Lowe responded, "[a]gree – no connection at all."

On September 22, 2011, Lowe sent Pearce and [redacted] copying [redacted] the revised [redacted] Consent Order that included "a definitive provision on refraining from RAL lending and… a provision addressing Dollars Direct (including policies, procedures, and audit coverage), and requiring a specific plan to exit if directed by RD [Regional Director]." [redacted] approved of the proposed Consent Order and a civil money penalty of $145,000 or greater.

On October 17, 2011, [redacted] stipulated to the Consent Order, order for restitution, and order to pay CMPs. Among other things, the Consent Order stated that the institution had exited the RAL business and would not resume that type of lending. Notably the Order ***did*** allow [redacted] to continue its Dollars Direct program.[86] [redacted] paid a $145,000 civil money penalty. Then, on November 17, 2011, the FDIC issued the Consent Order, signed by [redacted]

XXX. Pearce's Settlement Negotiations, and Ultimate Settlement, with [redacted]

In September 2011, Pearce took over settlement negotiations with [redacted] from [redacted] in an attempt to get the bank to exit its RAL business. When interviewed by our office, Pearce explained that he negotiated directly with CEO [redacted] because communications between [redacted] and the FDIC had become adversarial by this point and he thought he was in the best position to reach a resolution with [redacted] Pearce thought he had a better chance of reaching a settlement because of his title and the fact that he had no history with the bank, giving the bank higher confidence that it could reach a resolution with him. Pearce felt he was "well-positioned to reach a positive outcome." He told us he did not involve Legal in the negotiations because, by this time, he would not have used [redacted] and he felt he was responsible as the "supervisory person."[87] Pearce stated that during the negotiations with [redacted], he focused on the issues at hand: the report on the horizontal review, issues with the RAL business, positive ratings, and resolved supervisory issues relative to being on the FDIC's bidders list. He recognized that [redacted] had an interest in expanding and the bank was now willing to be more proactive in addressing examination concerns. [redacted] was unable to be on the FDIC's bidders list to acquire failing banks because of its "Needs Improvement" CRA rating, [redacted] composite S&S rating, [redacted] Compliance rating, and outstanding Consent Order from 2009.[88]

On September 9, 2011, [redacted] Pearce and [redacted] met about [redacted] At the time, [redacted] was about to undergo another round of S&S and Compliance examinations.

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86 We did not uncover an explanation for the FDIC's change in position with respect to [redacted] Dollars Direct Program.

87 It is noteworthy that Pearce was handling settlement discussions directly with [redacted]. The Legal Division is typically involved in the settlement negotiation process. When we interviewed [redacted] she stated that she knew Pearce and [redacted] had met and agreed that they could work out the settlement without involving Legal and that this is not the way it was normally done. [redacted] agreed that it was Pearce who was negotiating with [redacted]. [redacted] stated, Pearce "pretty much negotiated that [settlement] himself."

88 FDIC Directive Circular 6371.1 "Bidders List Preparation and Clearance Process" (December 20, 2004). For more on the bidders list, see Section XXXI.

According to [redacted] notes from the meeting, Pearce reported the he had met with [redacted] in [redacted] and that [redacted] "is looking forward to 'good'[examination] reports." [redacted] responded that "[e]xaminer 'quants' [FDIC's Quantitative Risk Analysis Section] can criticize [the] model but there are not large [RAL] losses." In fact, according to a type-written document attached to [redacted] notes from that day, the FDIC's economists in its Quantitative Risk Analysis Section had determined that [redacted] underwriting model:

did not address an individual's ability to repay a RAL based on the applicant's credit history. Nonetheless, taking the limited information received at face value, the economists determined that the Bank's 'underwriting model' adequately replaces the DI for determining whether tax refunds will be sufficient to repay RALs. Consequently, the absence of the DI and the use of the Bank's current 'underwriting model' do not expose the Bank to an abnormal risk of loss. This conclusion is borne out by the Bank's successful RAL season, in which it predicted a default rate of [redacted] before the tax season and, in fact, their default rate has been approximately [redacted].

[redacted] notes from the September 9, 2011 meeting also document comments from Pearce as follows: "Horizontal review demonstrates that they [[redacted]] did not do a good (enough) job of training EROs. Not terribly confident [that the] ALJ [Administrative Law Judge that hears FDIC enforcement cases] would recommend [[redacted]] exiting [the] tax business… Not allow [[redacted]] to bid [on failed institutions] until after out of RALs."

On September 30, 2011, Pearce wrote to [redacted], "I spoke with [redacted]r this morning regarding opportunities to resolve the outstanding issues related to the notice of charges and believe there is a meaningful prospect for resolution." Pearce explained that [redacted] and he had planned a meeting to be held in DC. He continued, ***"I think the going-forward applications/bidder list issue will be a key point…"***

On October 6, 2011, Pearce organized a conference call with [redacted] Lowe, [redacted] about a strategy for [redacted] Topics included "RAL program" and "Bidder List" among others. According to notes taken by [redacted] at the meeting, [redacted] and [redacted] also attended. The notes reflect that [redacted] ***stated she "[w]ould not be 'outraged' if [the] Debt Indicator [issue was] dropped out of the case."*** [redacted] stated that "[s]taff has been excluded. So cannot give you the best view re the case. 'Object to the idea [that] the case is without merit.'" [redacted] responded, "[w]hat do you win? Do we get an order saying 'no more RALs'?" Pearce then discussed the terms of the settlement and [redacted] stated that they "[w]ill brief CRC on this next week." Lowe stated that, "[o]n RMS side exam is looking pretty clean." [redacted] added, "[s]eeing some compliance issues, not tied to RALs. Still looking at it." Lowe replied, "[l]et thrift [[redacted]] on bid list, now, even if [redacted] bank is not on yet?"

Then on October 16, 2011, [redacted] emailed Pearce, [redacted] and Lowe, copying [redacted] and [redacted] explaining and attaching a draft settlement term sheet for [redacted] for their review. Notably with respect to mergers, acquisitions and bidding [redacted] proposed the following language:

After April 20, 2012, the FDIC will permit [redacted] to join the bidders list for failed banks and will consider [redacted] applications for acquisitions or mergers, provided that: a) [redacted] has fully complied with the terms of the Consent Order; b) [redacted] has fully complied with the terms of the Plan; and c) [redacted] meets the statutory and regulatory requirements needed for approval of bids and acquisitions as well as mergers.

Pearce provided edits to the term sheet and asked the group for feedback that day (a Monday) because he wanted to send terms to [redacted] by mid-week.

That same day, Lowe emailed [redacted] and provided an overview of the ongoing examinations at [redacted] and the EICs' preliminary findings., ***"…[T]he CM [Compliance] and RM [Risk Management/ S&S] exams, conducted by two of our most seasoned examiners, are concluding that appropriate efforts have been taken by the bank to address previously identified weakness, and upgrades in ratings are in order (Risk to [redacted], Compliance TBD – between [redacted] and [redacted]). Absent conducting another horizontal review of EROs during the tax season, it will [be] difficult to make the case that the bank remains high risk, relative to its compliance program and third party oversight. So should we try to simplify our negotiations/agreement with the bank to the larger issues: exit RAL, pay a sizeable CMP, direct additional resources for ongoing oversight of third party?"*** [redacted] replied that her "initial thoughts on the term sheet were consistent with [Lowe's]." She also forwarded the chain to Pearce. ***Therefore, as Pearce was negotiating a Consent Order with [redacted], he was aware that the underlying concerns supporting a Consent Order had been resolved. In particular, and as described above, he knew that the bank's RAL underwriting model had proven effective in 2011 for the 2010 tax season.***

One of the "seasoned examiners" referenced by Lowe was [redacted] the same examiner who had reviewed [redacted] underwriting plan, as described above in Section XIII. [redacted] told us that he was brought in as the EIC for the [redacted] 2010 S&S Examination as a "clean set of eyes" and that [redacted] tried to "shield him from Washington" during the examination. [redacted] instructed [redacted] to tell him if anyone from the WO interfered. Despite this, [redacted] reported that [redacted] reached out to him during the [redacted]c 2011 S&S Examination. [redacted] called to tell him that the "quants" had found problems with [redacted] RAL underwriting model. [redacted] told us he found this unusual because he had been specifically told at the outset of the examination that, under no circumstances were he and the other examiners to examine the model or ask questions about the model, so this line of inquiry was outside the scope of the examination. However, [redacted] recalled calling a female in the "quants" section and she informed him that they had no issues with the model and that it worked quite well. [redacted] told us that, at this point, he believed [redacted] was not telling him the truth. [redacted] also received a comment that [redacted] had made on the text of the 2011 S&S Examination. The original text read:

The IRS ceased providing its 'Debt Indicator' (DI) tool for the 2011 tax season. This tool was one of the principal factors used by TRS to determine the likelihood of the IRS funding the refund request. The division experienced modest loss rates of [redacted] and [redacted] of the RAL population in 2009 and 2010, respectively. Management anticipated losses to be higher in the 2011 season and budgeted for a loss rate of [redacted]. Actual results through September are running better than anticipated (although higher than past years) at [redacted]. This loss rate has not had a materially adverse effect on the division's, or the whole bank's, earnings performance. The division compensated for higher losses via a combination of a shift in refund products favoring ERCs and ERDs, as well as via processing a higher volume of tax returns.

[redacted] commented "This may need to be re-worded so it doesn't give the impression that we had no reason for concern about 'ability to repay.'" [redacted] told us that he thought it was odd that someone from the compliance side was providing direction on a S&S examination. He stated, as Lowe reflected above, that the examination "came out clean at the end of the day" and that [redacted] was properly running its RAL program.

On October 18, 2011, [redacted] and Lowe both provided comments on the term sheet. Specifically, [redacted] incorporated concepts suggested by [redacted] and [redacted] added a provision "in regard to bidding/mergers, addressing our agreement to promptly respond to request from other agencies involving transactions being facilitated through the HC [holding company], or the affiliate in [redacted]

On October 19, 2011, Pearce wrote to [redacted] and [redacted] copying [redacted] and [redacted] that he had "[s]ent the attached term sheet to [redacted] today and walked him through it on the phone." Pearce pointed to two questions asked by [redacted], one on the length of time the provisions would remain in place and the other was "[w]hat level of scrutiny will FDIC [have] going forward on ERO's providing ERCs [Electronic Refund Checks] and ERDs [Electronic Refund Deposits]? I told him we expected our supervision (and his audit program) to be commensurate with the risks of this activity, noting (as we have in the past) that the elimination of the RAL product reduces the regulatory, compliance, and reputational risks." Pearce updated the same group on October 24, 2011, stating that he had spoken with [redacted] that day and had discussed a number of outstanding issues. Pearce said that he and [redacted] were "shooting to make significant progress by Nov 16th board meeting…" He also noted that "[redacted] suggested [a] $100k CMP, which I told him was the same as offering $0."

On November 9, 2011, Pearce sent a memorandum entitled "Consumer Protection Update – Week of November 7, 2011" to the then-Acting Chairman **Gruenberg**. Included was an update on [redacted] that read, "[t]here is a fair chance of resolving [redacted] matter in the next 30-60 days… Possible settlement outcome involves agreement to exit RAL business (though not until after the 2011 tax return season) and improve third-party oversight for other tax-related products."

On November 11, 2011, [redacted] wrote to Pearce as a part of their continuing settlement negotiations. He stated, ***"[w]ith regard to the Civil Money Penalty, we would be receptive to an amount greater than $500,000 in the event we are able to come to a conclusion and resolution on all matters resulting in our immediate ability to resume expansionary activities including acquisition of failed institutions with FDIC assistance. I understand that any such resolution would be subject to the conclusion of all pending exams with satisfactory or better ratings prior to execution of the Consent Order."***

Then on November 18, 2011, Pearce sent another Consumer Protection Update memorandum to **Gruenberg** that included a reference to [redacted] as follows, "[redacted] negotiations nearing completion – should know outcome within the next two weeks."

[redacted] and Pearce continued to exchange emails and draft language relating to the settlement on November 19, 20, and 23, 2011. Then on November 25, 2011, [redacted] emailed Pearce, attaching further edits to the Consent Order and Consent Agreement drafts. He wrote, "[w]e are only a few words away on these so I'm confident that if you would agree to the most recent drafts of the ERO Oversight Plan we will come to terms on the Consent Order and Stipulation."

On November 26, 2011, Lowe sent Pearce the draft Compliance and S&S Examinations, both of which raised [redacted] ratings to "2."

On November 27, 2011, Pearce emailed [redacted] copying [redacted] and [redacted] forwarding [redacted] November 25, 2011 email and adding his own message:

[redacted] and I are working on the final pieces of the resolution for [redacted] close to the lines you and I discussed a week or so ago:

1. *[redacted] will agree to exit RAL business, after next tax season*
2. *[redacted] has submitted a plan for improved oversight of tax preparers…*
3. *[redacted] will pay a $900,000 CMP*
4. *FDIC agrees that [redacted] can file applications after Consent Order executed and we will consider them in accordance with our normal procedures.*

The draft RM and Compliance exams indicate a '2' rating for both*… Let me know if you have any concerns before I let the horse out of the barn.*

On November 28, 2011, Pearce sent the draft Compliance and S&S (also referred to as Risk Management) Examinations to [redacted] for her to review and stated, ***"I am a bit concerned at description of tax products and mgmt oversight in both RM and Compliance sections, given the outstanding notice of charges…"*** (ellipse original)

[redacted] subsequently added the following language to the Compliance ROE. ***"As noted above, the findings and recommendations from the February 2011 [Horizontal Review] Visitation were not reviewed as a part of this examination. The assessment of the Bank's efforts to address deficiencies noted is being handled under separate cover."*** [redacted] then sent the revision to Pearce. [redacted] also sent suggested changes to [redacted] for the S&S ROE on November 29, 2011. [redacted] concurred and forwarded the change and comments to Lowe and [redacted] Pearce also sent [redacted] changes to the Compliance ROE to Lowe.

On November 30, 2011, Pearce sent [redacted] the draft examination reports.

As we have discussed, these reports generally do not consider issues identified in the February 2011 [Horizontal Review] Visitation; however, they do presume that the issues identified in that Visitation and in the subsequent Amended Notice of Charges will be addressed and resolved satisfactorily. The Region will finalize and issue these reports immediately after the Board has taken final action to address those issues.

This appears to tie the bank's ratings directly to the settlement.

[redacted] replied, in part, ***"I understand from our phone conversation that the signed Consent Order and Stipulation as well as the ERO Oversight Plan resolve the issues related to the Report of Visitation [Horizontal Review]. It would be helpful to have some reference to the settlement's resolution of the ROV [Report of Visitation] in the exam."*** Pearce forwarded the chain to [redacted] and [redacted] copying [redacted] and [redacted] and asked them to review the documents to ensure they matched the previous draft. He also alerted them that "I have briefed [redacted] and [redacted] will notify CRC members later today," that the settlement will be signed the following week by [redacted] Board and FDIC management. Pearce also sent the final draft Stipulation, Order and ERO Oversight Plan documents to [redacted], and [redacted] copying [redacted] and Lowe.

When interviewed as a part of this Inquiry, [redacted] said that in light of the fact that the September 12, 2011 Compliance Examination did not review actions the bank took to address concerns found during the horizontal review, she thought it was a "strong arm tactic." She said that the horizontal review was DCP-driven by a strong belief that they would find "a raft" of violations. [redacted] said that the reviews did find some violations, but at the end of the day, they were not as serious as they thought and it "did not pan out."

Also on November 30, 2011, [redacted] emailed [redacted] copying [redacted] and Pearce the "Briefing Update for **CRC Members"** regarding [redacted] provided a memorandum to be circulated to the CRC. She explained the terms of the settlement. "The Bank will exit the RAL business on or before April 30, 2012 and not resume it thereafter. The Bank will pay a CMP of $900,000. The FDIC will terminate the Cease & Desist Order issued on February 27, 2009." She also stated that the settlement included the bank submitting an acceptable ERO Oversight Plan, which they had done, and dismissing their lawsuit against the FDIC.

Pearce emailed **Gruenberg** and [redacted] that day at 3:13 p.m. as well, alerting them of the settlement with [redacted] He emailed them again at 4:53 p.m. attaching the Consent Order and Stipulation for [redacted] and highlighting ***"[t]he operative language from the Stipulation regarding applications is pasted below. It has been approved by Legal and RMS."*** The language pasted from the Order into Pearce's email is as follows:

Provided that the Bank has complied with the terms of this CONSENT AGREEMENT, the FDIC agrees that it will consider any merger applications filed with the FDIC by the Bank and any requests by the Bank for clearance to bid on the assets and deposits of failing institutions. In considering such merger applications or requests for clearance to bid that may be submitted by the Bank, the FDIC will apply the same requirements, standards, and policies that the FDIC typically applies with respect to any other insured depository institution. The Bank may file such merger applications or requests for clearance to bid immediately upon acceptance of this CONSENT AGREEMENT by the FDIC.

We asked **Gruenberg** if [redacted] ability to get on the FDIC's bidders list or the provision above was a focus of his attention at the time. He stated that he could not remember.

On December 2, 2011, [redacted] Board met to discuss the settlement. [redacted] reported to Pearce, on December 3, 2011, that "[e]verything went well at the Board Meeting yesterday and I expect to have everything signed and finalized early next week." They continued to correspond to finalize logistics of signatures and timing.

On December 5, 2011, [redacted] ***provided a check for $900,000 in civil money penalties. That same day,*** [redacted] ***sent a memorandum to*** [redacted]***, Subject: "Request for Consultation – Double Upgrade on Compliance Rating Composite*** [redacted] ***to Composite '2'" for*** [redacted] [redacted] explained:

The scope of the current examination also included a limited follow-up review and discussion with bank management regarding concerns identified in the February 2011 FDIC Visitation Report. The February 2011 Visitation was a targeted review of the bank's non-traditional tax refund business that is conducted through Tax Refund Solutions (TRS), a division of the bank. However, ***due to the timing of this examination, and the fact that the 2011 tax season had already concluded, the scope of the current examination did not test the effectiveness of actions taken by the bank to address the concerns noted during the February 2011 Visitation****.*

Put simply, the horizontal review results that involved approximately 400 examiners visiting some 250 institutions were not considered when the FDIC decided to double-upgrade [redacted] composite rating. Equally, the optics of the ratings upgrade being issued on the same day that [redacted] provided a check for CMPs is concerning. When interviewed as a part of this Inquiry, [redacted] agreed the appearance was "not good."

On December 7, 2011, [redacted] emailed [redacted] for [redacted], copying Pearce, [redacted] and others, [redacted] settlement talking points. Among other question and answer pairs:

> ***Question:*** *Has the FDIC finally driven banks out of the RAL business? Are there any other banks involved in this line?*
>
> ***Response:*** *The FDIC's actions regarding RAL business were to ensure that banks handle all their operations consistent with safe, sound, and prudent banking practices, and with the primary objective of conserving capital. We do not discuss open operation banks with anyone other than the banks and their Boards of Directors.*

That same day, a meeting regarding the FDIC's press release on the [redacted] settlement was also organized by the then-**Acting Chairman's** office to include himself, Pearce, [redacted] and [redacted]

Finally, on December 8, 2011, the FDIC formally issued the Consent Order and an order to pay a $900,000 civil money penalty. [redacted] agreed to exit the RAL business on or before April 30, 2012 and never resume thereafter. Such a provision is unusual in FDIC Consent Orders, as the FDIC typically allows an institution to re-enter lending activity after consulting with, or obtaining a non-objection from, the FDIC. When interviewed by our office, [redacted] admitted it is rare to ask a bank to exit a line of business. [redacted] also told us it was atypical. [redacted] also agreed to voluntarily dismiss the lawsuit it had filed against the FDIC on March 11, 2011, and the FDIC terminated the Consent Order from 2009 to which [redacted] had previously been subject. With the upgrade to a composite [redacted] rating in place and the issues associated with the previous Consent Order and horizontal review behind them, [redacted] was eligible for addition to the FDIC's bidders list of banks who could purchase failing institutions, the outcome that [redacted] had always been clear that he wanted.

On December 9, 2011, Pearce's secretary emailed [redacted] and him with a draft [redacted] press release. That same day, discussions occurred between Pearce, [redacted] and others about an internal message to all DCP staff, and potentially others, regarding the [redacted] settlement and thanking them for their work on the horizontal review. Lowe noted, ***"[m]y only concern – if the email becomes public – is the potential public or industry perception that the entire agency was engaged in an action against an individual bank."***

XXXI. Qualified Bidders List and [redacted] Purchase of [redacted]

According to the FDIC's Franchise Marketing Website:

The FDIC invites approved and qualified bidders to participate in acquisition opportunities by means of a bid list. Bid lists are created for each acquisition opportunity based on potential acquirer's qualifications and interests and characteristics of the failing bank such as capital ratios, regulatory ratings, assets and core deposits as reported on the most recent Call Report and geographic location of the bank. Each bid list is developed using several criteria sets to identify approved potential bidders for an acquisition opportunity, while considering factors that match likely approved bidders to an acquisition opportunity. In order for an institution or organizing group to be included on a bid list, they must be an insured financial institution or have a shelf charter approved. Banks qualified for a bid list will be notified of the applicable acquisition opportunity by email and granted initial access to the FDIC's virtual data room.[89]

Directive Circular 6371.1 "Bidders List Preparation and Clearance Process" (December 20, 2004) explains that "DSC [now split into RMS and DCP] is responsible for pre-approving potential bidders for failing institutions and for assessing the risk to the deposit insurance fund(s) posed by potential resolution transactions." The more recent Franchise Marketing Job Aid 1.B "Create A Bid List," dated June 2015, points to RMS as the Division to assist with determining an institution's qualifications for inclusion on a bid list, using the criteria in Circular 6371.1. That criteria includes: geography, overall financial condition ("[a]s a general rule, potential bidder institutions must evidence satisfactory financial condition … composite ratings of '1' or '2.'"), asset size, management ("tantamount to a CAMELS management component rating of '2' or better"), anti-money laundering record, and minority ownership.

According to the Job Aid, the person compiling the bid list should "[s]end the Regional Manager the bid list criteria memorandum. The RM contacts RMS Regional Manager and Case Managers to discuss criteria." The Job Aid also counsels, "[a]lways make sure that any individual institutions not meeting the normal supervisory criteria are cleared by the RMS Case Manager before adding them to the list."

At the time, for [redacted] the [redacted] and the [redacted]. [redacted] entered the finalized change in the bank's ratings in ViSION on [redacted], the same date the report was mailed to the bank. We conferred with [redacted] and [redacted] as a part of this Inquiry. [redacted] said that it takes about two days for the information in ViSION to update into the Franchise Marketing system.

On December 8, 2011, the same day the Consent Order was issued, [redacted], wrote to [redacted] copying Lowe

[89] https://www.fdic.gov/buying/FranchiseMarketing/bid_lists.html (As of November 29, 2015).

and [redacted] about [redacted] status. "They are excluded from the resolution process. Do you want that hold to continue?" Lowe responded, "[f]or now – yes. Expect restrictions to change, though, within the next week or so." [redacted] replied, on December 12, 2011, "[w]e have received a call in Dallas from… [redacted] wanting to get on the bidders list. Please let me know when the hold should be taken off." Lowe responded, on December 13, 2011, that the "[h]old is off now" and [redacted] was added that day to the qualified bidders list and to the bid list for [redacted] (as well as two other banks that [redacted] did not end up being interested in purchasing). [redacted] was then able to access the secure site to review the marketed bank's information. ***In other words, three business days after the Consent Order was issued and five business days after*** [redacted] ***wrote its $900,000 CMP check and was upgraded, the bank was on the bidders list.*** [redacted] ***acquired*** [redacted] ***on January 27, 2012, and ultimately purchased a total of three banks in 2012.*** [redacted] ***had not agreed to exit RALs until April 2012 and was therefore still in the business at the time it purchased*** [redacted]**.**

[redacted] told us that then-Acting Chairman **Gruenberg** was surprised at how quickly [redacted] was able to purchase a bank. **Gruenberg** was also alerted to another potential [redacted] purchase. On March 22, 2012, Lowe wrote to a group that [redacted] was interested in bidding on [redacted] that would be failing April 13, 2012. [redacted] forwarded the message to [redacted] who forwarded it to **Gruenberg**.

XXXII. Conclusion

The facts developed by this review strongly reinforce the concerns and issues raised in the OIG's earlier Audit. In our view, the FDIC must candidly consider its leadership practices, its process and procedures, and the conduct of multiple individuals who made and implemented the decision to require banks to exit RALs. While we acknowledge that the events described in our report surrounding RALs involved only three of the FDIC's many supervised institutions, the severity of the events warrants such consideration. The FDIC needs to ask how the actions described in our report could unfold as they did, in light of the FDIC's stated core values of integrity, accountability, and fairness. Further, the Corporation must address how it can avoid similar occurrences in the future.

In December 2015, in response to concerns raised in the Audit, the FDIC removed the term "moral suasion" from its guidance. We appreciate the central importance of informal discussions and persuasion to the supervisory process; however, we believe more needs to be done to subject the use of moral suasion, and its equivalents, to meaningful scrutiny and oversight, and to create equitable remedies for institutions should they be subject to abusive treatment.

Because our work is in the nature of a review, and not an audit conducted in accordance with government auditing standards, we are not making formal recommendations. However, we request that the FDIC report to us, 60 days from the date of our final report, on the steps it will take to address the matters raised for its consideration.

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Mark Pearce	Director, Division of Depositor and Consumer Protection (DCP), Washington, DC
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Examination Dates and Ratings

[redacted]

Safety and Soundness

Start Date	5/19/2008	7/20/2009	8/30/2010	9/26/2011
Examiner Completion Date	07/16/2008	09/03/2009	10/01/2010 (FDIC); 10/06/2010 (State)	11/01/2011
CAMELS Rating	[redacted]	[redacted]	[redacted]	[redacted]

Compliance

Start Date	3/31/2008	10/19/2009	9/12/2011
Examiner Completion Date	12/04/2008	07/22/2010	12/02/2011
Compliance Rating	[redacted]	[redacted]	[redacted]

[redacted]

Safety and Soundness

Start Date	2/11/2008	3/23/2009	10/25/2010	12/22/2011
Examiner Completion Date	05/09/2008	05/14/2009	01/19/2011	02/15/2012
CAMELS Rating	[redacted]	[redacted]	[redacted]	[redacted]

Compliance

Start Date	7/17/2006	5/15/2009	12/21/2011
Examiner Completion Date	3/02/2007	12/29/2010	3/06/2012
Compliance Rating	[redacted]	[redacted]	[redacted]

Examination Dates and Ratings

[redacted]

Safety and Soundness

Start Date	11/26/2007	1/12/2009	2/16/2010	2/22/2011
Examiner Completion Date	01/04/2008	02/11/2009	05/27/2010	05/11/2011
CAMELS Rating	[redacted]	[redacted]	[redacted]	[redacted]

Compliance

Start Date	09/15/2004	8/27/2007	9/13/2010
Examiner Completion Date	10/06/2004	11/27/2007	04/01/2011
Compliance Rating	[redacted]	[redacted]	[redacted]

FDIC Enforcement Actions and Orders

Informal Actions

Informal actions are voluntary commitments made by the Board of Directors/trustees of a financial institution. They are designed to correct identified deficiencies and ensure compliance with federal and state banking laws and regulations. Informal actions are neither publicly disclosed nor legally enforceable.

Board Resolution	Informal commitments developed and adopted by a financial institution's Board of Directors/trustees, often at the request of an FDIC Regional Director, directing the institution's personnel to take corrective action regarding specific noted deficiencies. The FDIC is not a party to the resolution, but approves and accepts the resolution as a means to initiate corrective action
Memorandum of Understanding (MOU)	An MOU provides a structured way to correct problems at institutions that have moderate weaknesses, but have not deteriorated to a point requiring formal corrective actions. An MOU may be appropriate if examiners (after discussing examination findings with field and regional office personnel and the bank), determine that the board of directors and management are committed to, and capable of, implementing effective corrective measures.

Formal Enforcement Actions

Formal enforcement actions are those taken pursuant to the powers granted to the FDIC's Board of Directors under Section 8 of the Federal Deposit Insurance Act (FDI Act) 12 U.S.C § 1818. Each situation and circumstance determines the most appropriate action(s) to be taken. Formal enforcement actions are publicly available records.

Written Agreement	A formal written agreement is entered between a insured depository institution and its appropriate Federal banking regulator. The written agreement may require that specific activities be prohibited and/or certain actions be taken. It has the same effect as an order to cease and desist and is issued pursuant to FDI Act Section 8(a) or 8(b).

FDIC Enforcement Actions and Orders

Formal Enforcement Actions	
Cease and Desist Order (Consent Order)	Under Section 8(b)(6), the FDIC attempts to obtain consent from a bank to a Cease and Desist Order in an effort to eliminate the need for time-consuming administrative hearings. The Consent Cease and Desist procedure is premised upon agreement to a stipulation between the representatives of the FDIC and the bank's board of directors whereby the bank agrees to the issuance of a Cease and Desist Order without admitting or denying that any unsafe or unsound practices and/or violations of law or regulation have occurred. The effect of this procedure is to reduce the time period between initial review of the case and the date on which an enforceable and binding Cease and Desist Order is issued. Concurrence of the State supervisor is sought; however, failure to obtain such concurrence would not be a reason to discontinue the pursuit of Section 8(b) action. The responsibility for negotiating a stipulation with the bank's board of directors is generally that of the FDIC Regional Counsel and other Regional Office representatives. If an institution voluntarily agrees to the entry of a Cease and Desist Order, the order is entitled a "Consent Order."
Notice of Charges	Section 8(b) provides that the FDIC may issue and serve a Notice of Charges upon a State nonmember insured depository institution in the following instances: 1. The bank is engaging, or has engaged, in unsafe or unsound practices; 2. The bank is violating, or has violated, a law, rule, or regulation, or any condition imposed in writing by the FDIC with regard to the approval of a request or application, or a written agreement entered into with the FDIC; or 3. There is reasonable cause to believe the bank is about to do either of the above. The Notice contains a statement of facts relating to the practices or violations and fixes a time and place for a hearing to determine whether a Cease and Desist Order shall be issued.
Civil Money Penalty	Insured depository institutions and institution-affiliated parties may be assessed monetary penalties for engaging in unsafe or unsound banking practices or violations of law or failure to comply with an order issued by the appropriate Federal banking regulator (Section 8(i)(2)).

Sources: Federal Deposit Insurance Act, Section 8; 12 CFR §308 (Rules of Procedure; multiple subparts); Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies; Interagency Notification and Coordination of Enforcement Actions by the Federal Banking Regulatory Agencies; FDIC Compliance Examination Manual- September 2015; and RMS Manual of Examination Policies.

[redacted] Changes

As a part of this Inquiry, [redacted] for [redacted] October 25, 2010 S&S ROE, provided OIG investigators with a copy of the ROE, as he had submitted it, on October 7, 2015. His [redacted] made changes to [redacted] version of the ROE at [redacted] direction. These changes included a change in the composite CAMELS rating from a "[redacted]" to a "[redacted]." The management component was also changed from a "[redacted]" to a "[redacted]." Additional language was added to the "Summary" section of the report. The report now identified concerns with risk management of the bank's Tax Division's loan products and adverse compliance findings in the area. Management oversight of the Tax Division was called "ineffective," while management oversight was not discussed in the prior version. The edited version concluded that ineffective management increased reputational and third-party risks. The chart below shows examples of changes in specific language:

Original	After Regional Office Editing
Capital and liquidity are strong.	Capital, asset quality, earnings, and liquidity are satisfactory, but can be impacted by risks associated with the Tax Division's loan products and [redacted].
Excluding the multiple violations of Section 5 of the Federal Trade Commission Act, that prohibit unfair or deceptive practices, the bank meets the standards for satisfactory CRA performance.	Multiple violations of Section 5 of the Federal Trade Commission Act, regarding the prohibition of unfair or deceptive practices, are the main cause of the "Needs to Improve" rating.
Management and the board of Directors have the appropriate experience and expertise to adequately oversee the traditional operations of the bank; however, the unsatisfactory compliance management system and the lack of adequate supervision of outside individuals involved with the tax-related products and [redacted] continues to be a regulatory concern.	Management and the Board of Directors need to improve risk oversight, particularly as it pertains to non-traditional products.
Earnings are adequate to support operations and adequately fund the allowance for loan and lease losses.	Earnings are adequate to support operations and adequately fund the allowance for loan and lease losses, although earnings performance excluding income generated from the RAL and [redacted] is only moderately sufficient to augment capital.

Changes to ROEs

Original	After Regional Office Editing
The budget for the year 2010 projects net income of $3,166M, resulting in ROAA of 1.21 percent. The earnings performance is on track to meet budgeted income. Profit plan committee minutes indicate that the budget is reviewed quarterly; however, no written Profit Plan has been created for 2010.	Profit plan committee minutes indicate that the budget is reviewed quarterly; however, no written Profit Plan has been created for 2010.

Significant Omissions

In addition, the following statements written by the EIC were omitted from the ROE:

1. "The traditional aspects of bank operations are generally satisfactory."
2. "Asset quality pertaining to the loan portfolio has improved and earnings are adequate."
3. "Management and the Board are experienced and administer traditional bank operations in a generally satisfactory manner."
4. "The review of the Tax Division took place immediately after the onsite portion of the S&S examination notes that modification of the RAL program resulting from the withdrawal of the IRS debt indicator will result in a substantial decrease in the number and dollar volume of RALs in 2011. While RAL losses have been low in relation to loan volume, the product's risk profile increases significantly without the debt indicator."

Significant Additions

The [redacted] RO completely changed a paragraph discussing "Compliance with Enforcement Actions and Board Resolutions." The EIC originally noted management's adherence to four of the five provisions of the April 29, 2009 S&S Board Resolution. The original report noted the bank needed to enhance its audit program for the RAL and [redacted]. After the [redacted] RO review, the report primarily discussed the inadequacies of the RAL and [redacted]. Instead of saying the bank complied with four out of five of the provisions, the report was changed to, "Although management has complied with some of the provisions of the Resolution, enhancements are needed to improve the quality of the methodology of the allowance for loan and lease losses, the Profit Plan, and the audit function. Refer to the Compliance with Enforcement Action page for additional details."

Changes to ROEs

The Management section of the report was changed to include an additional paragraph discussing the effect of the consumer compliance violations in the management rating. Additionally, a paragraph discussing the IRS debt indicator was added to the report.

Finally, within the earnings section of the report, the [redacted] RO added comments describing the impact of RALs on earnings.

[redacted] and Trust Changes

We obtained the original version of [redacted] August 30, 2010 S&S ROE that [redacted] submitted to the [redacted] RO. After submission, the [redacted] RO made changes to [redacted] report. These changes included a change in the composite CAMELS rating from a "[redacted]" to a "[redacted]." Other components changed include the bank's Earnings component from a "[redacted]" to a "[redacted]," and the liquidity component from a "[redacted]" to a "[redacted]." The chart below shows examples of changes to specific language:

Original	After Regional Office Editing
The financial condition of the institution is strong; however, the continued presence of a deficient consumer compliance program is a regulatory concern.	The continued presence of a deficient consumer compliance program is a regulatory concern.
Liquidity is strong; sensitivity to market is moderate but suitably managed.	Liquidity is acceptable, and sensitivity to market is moderate, but suitably managed.
While the strong financial condition of the institution reflects favorably on the capabilities of management, the continued presence of an unsatisfactory compliance management program is a significant supervisory concern.	The continued presence of an unsatisfactory compliance management program, and the lack of a comprehensive strategy to minimize risks associated with the TRS program, are significant supervisory concerns.
Asset quality remains strong.	Asset quality remains satisfactory.
Earnings are strong.	Earnings performance is currently favorable, but may not prove to be sustainable should the bank's TRS business decline or if an acceptable debt indicator model cannot be developed.
Liquidity is strong and funds management practices are well developed.	Liquidity is acceptable and funds management practices are well developed.

Significant Omissions

In addition, the following statements written by the EIC were omitted from the ROE:

1. "Risk management practices are appropriate for the bank's risk profile."
2. "Management has enhanced its oversight of the TRS division since the last examination."

Significant Additions

A short paragraph was added to the Compliance/CRA section of the ROE. This basically stated that the FDIC would propose a Consent Order based on the findings from the Compliance Examination.

"The Board will need to improve its ability to assess and monitor its third-party risk."

Additionally, within the "Sensitivity to Market Risk" section, the [redacted] RO added the following:

"However, the current strong level of earnings is unlikely to continue in future periods due to change that will likely be needed pertaining to the TRS program."

Additional Detail on [redacted] Supervisory History with Respect to RALs

[redacted] had assets of just over [redacted] during the 2009-2012 time frame. [redacted] is a state non-member bank, and the FDIC and the state of [redacted] generally work together to conduct joint examinations issuing the bank a single report.

In prior years, examinations of [redacted] generally resulted in a S&S rating of "[redacted]." Most of these examinations were joint examinations with the State of [redacted]

In 2008, examiners noted the overall condition of [redacted] as "satisfactory." However, examiners also noted apparent violations of FDIC Rules and Section 103.22(b)(1) of the Treasury Department's financial recordkeeping regulations. Specifically, they identified Bank Secrecy Act and anti-money laundering process deficiencies. Examiners also identified concerns during a visit where examiners reviewed the TRS area. The ROE cited the bank for an apparent violation of [redacted] Revised Statutes for preservation of bank records. The bank was also in non-compliance with Appendix B of Part 364, Interagency Guidelines Establishing Information Security Standards. While asset quality was strong, examiners identified a contravention of FDIC Rules and Regulations Part 365 - Real Estate Lending Standards Appendix A. Examiners found [redacted] sensitivity to market risk "moderately high, but well-managed." The ROE noted capital, earnings, and liquidity were "satisfactory." They gave the bank a satisfactory rating for its information technology and trust operations management. The ROE noted the bank's Compliance and CRA examination were ongoing, and findings were not included within their report.

The ROE also discussed RALs. Specifically, the ROE described the program and its growth since the prior year. The ROE stated the RAL program has existed for over ten years. [redacted] significantly expanded its operation in the 2008 tax year by providing RALs through its agreement with over 1,600 [redacted] corporate-owned stores and increasing its independent tax preparer business. "Active electronic refund originators (EROs) for the 2008 tax season exceeded [redacted]. RAL volume increased [redacted] percent as of March 31, 2008, and total transactions, including electronic refund checks and deposits increased [redacted] percent and exceed [redacted] transactions."

The 2008 S&S ROE stated that "[m]anagerial, regulatory compliance, operational, reputation, and legal risks associated with this business line are elevated." The ROE noted that "[r]eview of the tax refund loan program identified inadequate controls over third-party tax preparers." The identified weaknesses resulted in the apparent violation of consumer protection regulations, non-compliance with the safeguarding of customer information contained in Appendix A of Part 364 of the FDIC Rules and Regulations, and an apparent violation of the State of [redacted] recordkeeping regulations. The ROE also identified concerns with management's slow charge-off of non-performing RALs. Finally, a security breach on the bank's Website resulted in the exposure of confidential customer information. The ROE noted that [redacted] stated that "[t]he RAL program weaknesses and violations of law are unacceptable, and that management was committed to investing the needed manpower and financial resources to ensure the program is operated in a satisfactory manner." Management developed a framework for 2009 program improvements during the examination.

In [redacted] May 27, 2008 Compliance Examination, the bank was downgraded from a "[redacted]" to a "[redacted]," and its CRA rating was downgraded from "Satisfactory" to "Needs to Improve." Comments regarding this examination include: findings from a Joint Examination Team approach that began on March 3, 2008. The visit to [redacted] focused on the RAL program, and examiners incorporated the findings into the ROE. Examiners identified critical weaknesses within the RAL program that led to substantive discrimination violations of 12 C.F.R. Part 202 Equal Credit Opportunity Regulation B (REG B). These violations were referred to the Department of Justice. Other violations involving the RAL program included Privacy, Truth in Lending, and Regulation E (12 C.F.R. Part 205 Electronic Fund Transfers Regulation E). Weaknesses were also identified in the bank's methods for obtaining signatures on legal documents. Compliance examiners felt the CMS for managing the risks associated with the RAL program and "extensive third-party relationships" was inadequate. The Compliance Examination noted, "[t]he audit function did not focus on the ECOA or fair lending issues."

The Compliance Examination noted the REG B violations had a "significant impact on [redacted] CRA program." "The widespread substantive violations of Regulation B, which implements the Equal Credit Opportunity Act, lowered the overall rating to Needs to Improve. The 2008 Compliance ROE SAER Information Sheet noted, "CRA is significantly impacted by the REG B violations, otherwise, would be rated Satisfactory."

[redacted] stipulated and consented to a Cease and Desist Order in February 2009 arising from deficiencies in the institution's CMS with regard to RALs and the institution's inability to adequately assess, measure, monitor, and control third-party risk.

In 2009, the State and the FDIC conducted a joint examination of [redacted] The July 20, 2009 examination found "[t]he condition of the institution satisfactory; however, Board and management oversight must improve." Again, examiners did not identify issues with the bank's management of its capital, liquidity, or sensitivity to market risk. While the volume of adversely classified assets increased, asset quality remained strong. The ROE reported improved earnings that supported [redacted] capital growth.

Examiners downgraded the Management component at this examination from a "[redacted]" to a "[redacted]." Examiners justified the downgrade by noting that management, "[h]ad not complied with consumer compliance regulations, nor fully corrected deficiencies in the TRS business segment, which were also identified at the prior safety and soundness examination, primarily in the management of third party risk."

The 2009 ROE acknowledged Management's institution of several program improvements in its oversight of the tax-related business lines. The ROE also noted program weaknesses identified during the 2009 tax season, some of which were consumer compliance related. In addition, the results of internal audit's mystery shopping program indicated that additional ERO training efforts were necessary to improve product delivery, disclosure, and ultimately customer product understanding.

Subsequent to the 2009 S&S Examination, compliance examiners conducted a Compliance examination of [redacted] as of October 19, 2009. Compliance examiners followed up on [redacted] efforts to administer an effective CMS to ensure compliance with applicable consumer protection and fair lending laws and regulations. Finally, examiners evaluated [redacted] performance under the CRA and determined the rating should remain as "Needs Improvement."

Again, the Compliance Examination rating of [redacted] was a "[redacted]." The Compliance ROE states the bank's compliance management made "some improvement;" however, examiners noted management was largely reactive to supervisory findings and did not exert sufficient oversight. The Compliance ROE specifically identifies management's insufficient oversight with respect to its "high-risk, non-traditional product lines." Further [redacted] "[p]olicies, procedures, monitoring, and training should be improved to identify and correct deficiencies." Compliance examiners stated, "[i]nternal procedures and controls have not proven effective to detect violations of Regulation B, as the institution had established a history of substantive violations in this area over the last several examinations."

Examiners credited management for improvements made in response to the last examination's findings; however, they noted oversight of third-party risk was "lacking." Examiners noted that "[s]ince the previous examination, several events have occurred that raise concerns with regard to the Board and senior management's ability to oversee the Bank's third-party risk and fair lending program." The report continued by identifying the lack of documented minutes for the Board and Compliance committee, prior to expanding the bank's RAL program, as evidence that leadership was out of touch with actions taken by bank management. The other concern identified was the bank's expanded number of ERO partners since the last examination. This increased the bank's third-party risk.

"During the 2009 tax season, [redacted], [redacted] [a federally chartered thrift institution and subsidiary of [redacted]], originated RALs, which were subsequently purchased by [redacted]." The Compliance Examination stated "[g]iven the outstanding Order, it was disconcerting that the Board did not notify the FDIC of this significant business decision."

The Compliance Examination notes that [redacted] "[l]argely corrected the illegal discrimination violation within the non-traditional bank products identified at the prior compliance examination." Examiners identified a significant REG B violation within the traditional bank product area during the 2009 examination. The violation represented "[t]he third examination, within the last four in which a substantive Equal Credit Opportunity violation is cited related to discrimination on a prohibited basis." The Compliance Examination notes the exact circumstances were different at each examination, but "[t]he continued presence of material findings in this area is indicative of weaknesses in management's oversight mechanisms."

The Compliance Examination describes [redacted] compliance policies and procedures as "weak within certain areas." Compliance monitoring is also described as "weak." [redacted] consumer complaint response procedures and audit function were described as "adequate."

On May 11, 2010, [redacted] emailed [redacted] and others, copying [redacted] about findings of the October 19, 2009 Compliance Examination. He wrote:

*With regard to the rating I understand the low rating is driven by the ECOA violations which occurred with the Bank's Commercial Loan Department. When there is a substantive ECOA violation involving discrimination as appears to be the case here the Bank's Compliance rating can be no better than a '3'. **The RAL program remains clean, and but for the ECOA violations the Bank would have a satisfactory rating**.*

Additional Detail on [redacted] Supervisory History with Respect to RALs

The February 11, 2008 S&S examination rated [redacted]. The 2008 ROE identified key concerns including asset quality issues such as management of collections and the asset quality function. The examination discussed the Tax Refund Anticipation Loan (TRAL) Program. Examiners noted inherent risk due to the type of loans the TRAL program generated. Discussion was limited to identification of concerns within the bank's audit program and ERO due diligence process. Examiners recommend annual reviews of the program (in line with expectations of higher risk programs) and they recommended additional "[d]ue diligence procedures regarding the acceptance of EROs into the program." The bank had pending litigation involving the non-payment of 35 official checks totaling [redacted]. The bank's loan losses were higher than the peer group. The bulk of their loan losses came from their consumer portfolio.

The March 23, 2009 S&S examination did not cite the TRALs as a weakness within the credit risk area. The ROE notes the bank engaged Jefferson Wells, Inc. to "[a]ssess ERO compliance with bank policy and procedures." The review identified incomplete product applications (a similar finding was identified in the 2006 Compliance Examination); however, they noted in most instances there was "supporting documentation that mitigated the technical deficiency." The 2009 S&S Examination noted that "[t]he Board promised correction of all apparent violations and deficiencies, and correspondence with the FDIC after the 2008 examination suggests progress has been made in addressing regulatory concerns."

The May 15, 2009 Compliance Examination took over 18 months to complete. While the examination remained open, on October 5, 2009, [redacted] attorney wrote to the FDIC's Ombudsman complaining that they had been unable to get an answer about a branch relocation from the FDIC because no answer would be provided until the completion of the Compliance Examination.

When the May 15, 2009 Compliance Examination was finally completed on December 29, 2010 it stated that "[a]lthough the Board made some efforts to provide the necessary framework to administer an effective compliance program… these efforts have not proven effective in preventing further deterioration in the bank's compliance posture." Focus was placed on nontraditional areas including the RAL program and issues raised by the Social Security Administration potentially involving the bank's [redacted]. However, one might conclude that the larger issue was the repeat violations regarding Truth in Lending disclosures; related to the bank's ARM products which had a negative financial impact on consumers. The ROE notes:

As mentioned previously throughout this Report, numerous substantive violations were identified involving unfair and deceptive acts and practices under Section 5 of the FTC Act. These *violations are related to multiple practices in the bank's ARM product line that have a very direct and adverse impact on consumers, including tangible financial harm that will require the bank to reimburse customers.*

Specifically, ARM adjustment pricing was not consistent or objective, increasing the risk for pricing disparities on a prohibited basis. Examiners took special note of:

- Inadequate monitoring of third parties without properly requiring periodic due diligence reviews during the course of the relationships;
- Inadequate contractual agreements between the third-party and the bank, specifically no requirements regarding safekeeping of loan documentation and other forms of personally identifiable information provided to the vendors;
- Inadequate policies/procedures governing the tax division;
- Inadequate audit of nontraditional products; and
- Lack of monitoring the marketing materials their third parties used to promote the bank's lending products.

The ROE discussed the third-party risks pertaining to the RALs program and some underwriting weaknesses, among other concerns.

A July 30, 2009, RAL (also known as "TRAL") Summary Memorandum provided an analysis of the Bank's RAL program as of the February 11, 2008 S&S Examination. The memorandum noted that the review of non-traditional products in the previous examination identified numerous instances of incomplete product applications; however, in most instances, supporting documentation mitigating the technical deficiency existed. The error rate was low, ranging between [redacted] percent. The memorandum noted implementation of expanded audit procedures during the tax season and specified that the focus of the expanded procedures was to ensure the EROs were in compliance with bank policy.

By March 31, 2010, examiners completed the review of [redacted] and RALs products, including visits to ERO and Electronic Fund Initiator providers. The [redacted] program was a direct-deposit product marketed to money service businesses such as check cashers and pawn shops. These businesses market the product to target individuals that do not participate in the banking system. The program provides check issuance and a debit card.

Examiners consulted with the WO regarding [redacted] UDAP violations for the [redacted] program and ECOA violations for RALs. Additionally, there was a consultation on the rating reduction and anticipated formal action. The consultation regarding the potential "4"

rating was initiated with the RO on September 13, 2010. Supporting documentation included identification of significant violations, two of which related to RALs or [redacted]
Attachments included:

- A note to file (July 15, 2010) that detailed two third-party related issues—UDAP ([redacted]) and ECOA—spousal signature (RALs);
- A note to file (July 27, 2010) on the internal consultation discussion for ECOA and that re-pricing issues did not identify any harm to consumers or complaints; and
- A note to file (July 27, 2010) that RO consultation for UDAP issues did not identify consensus on unfair practices or deceptive practices on overdraft fees, though it was identified as a harmful practice.

On September 22, 2010, an additional consultation was held with the [redacted] RO that determined the "product type" box being checked incorrectly for individual RALs, secured by joint tax refunds, was not a violation of ECOA. The September 22, 2010 [redacted] RO consultation also reviewed UDAP issues identified during the examination; these were forwarded to the WO for concurrence. Fair lending issues related to RALs were not found to be a violation, and the ECOA concerns with respect to ARM re-pricing needed additional analysis. The WO scheduled a visit for February 2011 to examine EROs during tax season.

During the consultation process, internal emails on October 21, 2010,[90] indicated the examination findings related to RALs were compliance risks associated with the third-party relationship management, specifically:

- Due diligence (both initial and ongoing) not commensurate with potential compliance;
- Legal, and reputation risks associated with the bank's third-party relationships conducted through the bank's Tax Division;
- Inadequate monitoring of both the Refund Anticipation Loan (RAL) and [redacted];
- Failure to oversee the practices of the third-party service providers;
- Failure to implement recommendations made in external and internal audits; and
- Failure to adapt the bank's CMS to effectively address third-party relationships.

[90] October 21, 2010 email from Lowe to [redacted] copying [redacted] and others, subject: [redacted]

The inadequate monitoring of the third-party relationships resulted in potential illegal discrimination on a prohibited basis and unfair practices under Section 5 of the Federal Trade Commission Act. The correspondence also stated that the RAL ECOA violations "were not as significant as the EIC may believe based on legal's review of the documents."[91] The communication concluded that the need to receive additional information to resolve "the myriad of"[92] open consultation questions was keeping the final mailing of the ROE in abatement. Internal correspondence from Lowe, also on October 21, 2010, noted the examination identified numerous weaknesses relative to third-party oversight, audit, training, and other facets of the RAL program, and reiterated the RO's pursuit of a formal action to force the bank's exit from RALs. Additional correspondence on October 27, 2010, continued to identify many open discussion items relative to WO Legal consultations for various potential UDAP and Fair Lending violations.

91 October 21, 2010 email from [redacted] to Lowe, copying [redacted] and [redacted] subject: "Other" RAL Banks.
92 Id.

Changes to the Civil Money Penalty Matrix

Additions **(*The FDIC must consider the following guidelines when recommending an assessment of a CMP against an institution…*)**
"A violation or practice that subjects the insured depository institution to substantial reputational risk or causes substantial harm to the public confidence of the institution." ***
"Weaknesses in the bank's third-party oversight that cause harm to consumers or the institution." ***
"Intentionally or repeatedly misreporting or failing to report government monitoring information relied upon by government agencies, or, where required by law, failing to implement systems to ensure the reporting or accuracy of this data." *
"The gravity of the violations, practices, or breaches," should be considered. It describes this as, "[a] violation, practice, or breach of fiduciary duty was particularly egregious should result in a larger recommended penalty…"
"Ability to Pay and Restitution," "The Matrix for CMPs Against Institutions should be used to calculate the and Restitution CMP amount before any adjustments are made for mitigating factors, such as the amount of financial resources of the institution." **
Creates new ranges of violation points and new asset categories based on the total asset size of the institution (i.e., up to $500 million, $500 million to $1 billion, and over $1 billion);**
Establishes a formula for calculating the CMP for institutions with total assets over $1 billion; **
Deletes references to considering informal actions, referrals, and supervisory letters; and
Establishes significantly higher possible penalty amounts. ***
Deletions
"In determining the appropriate amount of a CMP, the above assessment factors must be balanced against the mitigating factors contained in Section 8(i)(2)(G) of the FDI Act." Factor number two was removed: *"Good Faith;* *If the respondent cooperates throughout the proceedings, provides an explanation for his/her behavior that does not show malice or intentional disregard, voluntarily makes restitution to the intuition, and/or helps the regulatory agency or law enforcement in their investigations, then consideration may be given relative to the amount of the CMP. If an insured depository institution suffered a loss due to a violation, practice or breach of fiduciary duty, the violator's willingness and promptness in making restitution should also affect the amount of penalty assessed." ****

Items noted with an * would directly impact [redacted], ** would directly impact [redacted], and items noted with *** would directly impact both [redacted] and [redacted].

Changes to the Civil Money Penalty Matrix

[redacted] November 3, 2010 Regional Director Memo included the following changes to the Matrix used to determine the CMP from the 2005 Formal and Informal Action Procedures (FIAP) Manual:

2005 FIAP Matrix Factor	2005 FIAP Weight Factor	2010 Change to FIAP Matrix Factor	2010 Change to Weight Factor
Loss or Harm to Securities Holders or Consumers (Securities or Consumer Laws Only	5	Consumer harm and/or harm to public confidence; Unsafe or unsound (U/U) banking practice; Violation	10
Intent	5	Intent	8
1) Pecuniary Gain or Other Benefit to institution-affiliated party or Related Interest 2) Loss or Risk of Loss to Institution	4 6	Gain or other benefit to the institution; and/or loss or risk of loss to the institution	6
History	2	1) History of previous supervisory actions 2) History of previous violations or previous deficiencies	8 4
Number of Instances of Misconduct at Issue	2	Frequency of misconduct prior to notification or discovery	4
Duration of Misconduct Prior to Notification or Discovery	2	Duration of misconduct prior to notification or discovery (2)	4
Continuation after Notification	3	Continuation after Notification	6
Concealment	6	Concealment	5
Impact Other than Loss	6		
Additions to the Matrix			
N/A	N/A	Effectiveness of internal controls (IC) and compliance programs (CP) (11)	4
Items Reducing CMP			
Restitution	<2>	Restitution or other corrective action	<5>
Good Faith (Prior to Notification)	<3>	N/A, TAKEN OUT	N/A, TAKEN OUT
Full Cooperation (After Notification)	<2>	Cooperation and disclosure	<2>

Source: December 21, 2005 FIAP Manual and November 3, 2010 Attachment to Division and Supervision and Consumer Protection Memorandum System, Transmittal No. 2010-035. *Items surrounded by "<>" indicate a reduction in the total risk weight factor.

Changes to the Civil Money Penalty Matrix

Previous CMP Assessment Chart:

Points	Suggested Action
0-30	Consider not making referral
31-40	Consider sending supervisory letter
41-50	Consider assessing from $1,000 to $5,000
51-60	Consider assessing more than $5,000 (up to $10,000)
61-80	Consider assessing more than $10,000 (up to $25,000)
81-100	Consider assessing more than $25,000 (up to $75,000)
101-120	Consider assessing more than $75,000 (up to $125,000)
Over 120	Consider assessing more than $125,000

Updated CMP Assessment Chart:

Points from Matrix	Total Assets up to $500 Million	Total Assets $500 Million to $1 Billion	Total Assets Over $1 Billion
0- 60	None	None	None
61 - 70	$5,000 - $10,000	$10,000 - $20,000	Total Assets / 1 billion x penalty
71 - 80	$10,000 - $20,000	$20,000 - $40,000	Total Assets / 1 billion x penalty
81 - 90	$20,000 - $40,000	$40,000 - $70,000	Total Assets / 1 billion x penalty
91 - 100	$40,000 - $70,000	$70,000 - $110,000	Total Assets / 1 billion x penalty
101 - 110	$70,000 - $110,000	$110,000 - $160,000	Total Assets / 1 billion x penalty
111 - 120	$110,000 - $160,000	$160,000 - $220,000	Total Assets / 1 billion x penalty
121 +	$160,000 +	$220,000 +	Total Assets / 1 billion x penalty

Abbreviations and Acronyms

AD Assistant Director
AGC Associate General Counsel
APA Administrative Procedure Act
ARM adjustable-rate mortgage
BSA Bank Secrecy Act
CAMELS Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to market risk
CEO Chief Executive Officer
CFA Consumer Federation of America
CFR Code of Federal Regulations
CM Compliance Management
CMP Civil Money Penalty
CMS Compliance Management System
CRA Community Reinvestment Act
CRC Case Review Committee
[redacted]
CSBS Conference of State Bank Supervisors
DCP Division of Depositor and Consumer Protection
DI Debt Indicator
DIR Division of Insurance and Research
DRD Deputy Regional Director
DRR Division of Resolutions and Receiverships
DSC Division of Supervision and Consumer Protection
ECOA Equal Credit Opportunity Act
EIC Examiner in Charge
ERO Electronic Refund Originator
FDIC Federal Deposit Insurance Corporation
FIAP Formal and Informal Action Procedures
FIL Financial Institution Letter
FOIA Freedom of Information Act
IRS Internal Revenue Service
JET Joint Examination Team
[redacted]
MOU Memorandum of Understanding
NCLC National Consumer Law Center
NOC Notice of Charges
[redacted]
OCC Office of the Comptroller of the Currency
OIG Office of Inspector General
OO Office of Ombudsman
[redacted]
RAC Refund Anticipation Check
RADD Regional Automated Document Distribution
RAL Refund Anticipation Loan
[redacted]
REG B Equal Credit Opportunity Regulation B
[redacted]
RM risk management
RMS Division of Risk Management Supervision
RO Regional Office
ROAA Return on Average Assets
ROE Report of Examination
ROV Report of Visitation
SAER Summary Analysis of Examination Report
SARC Supervision Appeals Review Committee
S&S Safety and Soundness
TILA Truth in Lending Act
TRAL Tax Refund Anticipation Loan
TRS Tax Refund Solutions
UDAP Unfair and Deceptive Acts and Practices
U.S.C United States Code
ViSION Virtual Supervisory Information On the Net
WO Washington Office

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision
Legal Division

DATE: February 17, 2016

MEMORANDUM TO: [redacted]

FROM:

SUBJECT: Response to the Draft Report of Inquiry into the FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel

Thank you for the opportunity to review and respond to the Draft Report of Inquiry (Draft Report) into *The FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel*, prepared by the FDIC's Office of Inspector General (OIG). We believe that the supervision and enforcement activities discussed in the Draft Report were supported by the supervisory record and handled in accordance with FDIC policy. These activities occurred more than five years ago with respect to the three banks that offered refund anticipation loans (RALs).

EXECUTIVE SUMMARY

In August 2015, the FDIC Office of Inspector General (OIG) determined to conduct a review of the role of FDIC staff with respect to the FDIC's supervisory approach to three institutions that offered refund anticipation loans, or RALs. The findings were presented to FDIC in a Draft Report on January 21, 2016 (Draft Report). The Draft Report presented the OIG's view of the FDIC's handling of its supervisory responsibilities with respect to these three financial institutions that offered RALs between five and eight years ago.

We believe that the supervision and enforcement activities identified by the OIG were supported by the supervisory record and handled in accordance with FDIC Policy.

Summary of FDIC Response

- RALs, as described in a GAO report[1], are short-term, high-interest bank loans that are advertised and brokered by both national chain and local tax preparation companies. RALs carry a heightened level of credit, fraud, third-party, and compliance risk because

[1] United States Government Accountability Office Report, GAO-08-800R Refund Anticipation Loans (June 5, 2008) (stating "the annual percentage rate on RALs can be over 500 percent").

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they are not offered by bank loan officers, but by several hundred to several thousand storefront tax preparers (also referred to as electronic refund originators (EROs)).

- FDIC must provide strong oversight to ensure that the financial institutions it supervises are offering the product in a safe and sound manner and in compliance with applicable guidance and laws.
- FDIC issued relevant guidance for banks making RALs. In response to an OIG audit, FDIC issued a Supervisory Policy on Predatory Lending. Further, to describe its expectations for banks making loans through third-parties, FDIC issued Guidance on Managing Third-Party Risks.
- Supervisory issues were identified by field compliance examiners as early as 2004, including substantive violations of the Equal Credit Opportunity Act, weak ERO training, and a lack of RAL program audit coverage.
- One community bank grew its RAL program rapidly, nearly doubling the number of EROs through which it originated tax products between 2001 and 2004 to more than 5,600, and then nearly doubling that number again by 2011 to more than 11,000. By comparison, one of the three largest banks in the country at that time originated tax products through 13,000 EROs.
- Supervisory concerns increased through 2008 and 2009, as the management of two banks did not follow regulatory recommendations and directions, including provisions of enforcement actions.
- One of the three RAL banks moved its origination business to an affiliate without prior notice to the FDIC, effectively removing the RAL origination activity from FDIC supervision.
- The exit of large national banks and a thrift from the RAL business raised additional concerns, because similar prior exits had led to the business moving to the much smaller FDIC-supervised community banks.
- All three RAL banks conceded that the loss of the Internal Revenue Service (IRS) Debt Indicator would result in increased credit risk to the bank. The Debt Indicator was a key underwriting tool, supplied by the IRS, and used by the banks to predict the likelihood that a valid tax refund would be offset by other debt. Two of the three banks were unable to fully mitigate the risk created by the loss of the Debt Indicator, and neither substituted credit underwriting based on borrower ability to repay. The third bank may have had an acceptable underwriting substitute, but had such deficient controls and oversight that its RAL program was otherwise not safe and sound.
- The combination of risks outlined above caused the FDIC to ask the banks to exit the RAL business. All three banks declined.
- When poor practices of bank managements were not fully factored into examination ratings for two banks, Washington senior management provided direction to regional management, consistent with policy.
- Two banks were properly downgraded in the 2010 examination cycle based on well-defined weaknesses.
- The banks continued to decline to exit the poorly managed RAL programs.

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- Senior FDIC management recommended enforcement actions based on the supervisory records of the institutions.
- Senior FDIC management appropriately briefed the FDIC Chairman and other Board members on the supervisory actions being taken.
- While some members of the Legal Division raised concerns about litigation risk, the supervisory records supported approval of the enforcement cases, and supervision and legal officials ultimately approved them.
- The recommendations for enforcement action were reviewed by the FDIC's Case Review Committee (CRC), consistent with the FDIC Bylaws and the CRC governing documents.
- One of the final enforcement actions described violations of law by one of the RAL banks because of its efforts to impede examination activities.
- Settlement of the approved enforcement actions addressed the supervisory issues and was handled consistently with FDIC policy. It is not unusual for institutions that cannot engage in expansionary activities because of their condition to take steps to remedy regulatory concerns in order to regain the ability to expand.

We look forward to reviewing the details of the final report and will provide actions to be taken in response within the 60-day timeframe specified by the OIG.

Introduction

We reviewed the materials relied upon by the OIG, which included select email communications between FDIC employees, one former employee's personal notes, draft reports of examination, and information from interviews that OIG staff conducted with select past and current FDIC personnel. Having reviewed relevant materials, we believe that the supervision and enforcement activities that occurred with respect to the three banks discussed in the Draft Report were supported by the supervisory record and handled in accordance with FDIC policy. Nonetheless, the Draft Report did identify areas where better communication, both internally and externally, could have improved understanding of the agency's supervisory expectations and bases for action. Additionally, the Draft Report describes at least one instance in which a former employee – new to the FDIC at the time[2] – communicated with external parties in an overly aggressive manner. The FDIC does not condone such conduct, that type of conduct is not consistent with FDIC policy, and steps were taken to address the conduct at the time.

Risks of Refund Anticipation Loans

RALs are short-term, high-interest bank loans that are advertised and brokered by both national chain and local tax preparation companies. By their very nature, RALs carry a heightened level of credit, fraud, third-party, and compliance risk. Financial institutions must execute strong oversight of the storefront tax preparers (also referred to as electronic refund originators (EROs)) that originate RALs because banks are responsible for the actions of their third-party agents. Similarly, supervisory authorities must provide strong oversight to ensure

[2] The employee left the agency later that same year.

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that financial institutions are offering the product in a safe and sound manner and in compliance with applicable guidance and laws. Fewer than 10 financial institutions have ever offered RALs.

FDIC Took an Incremental Approach to Supervising Banks that Offered RALs

The Draft Report suggests that actions taken by the FDIC represented a sharp and rapid escalation in oversight of the institutions with RAL programs. The supervisory record, however, indicates that concerns were raised about risk management oversight of the RAL programs at the institutions for a number of years.

The FDIC first developed supervisory concerns with the risk management practices and oversight provided by the board and senior management of two institutions in 2004. FDIC had concerns with another RAL lender at the time that was not reviewed by the OIG. That lender exited the business in 2006 when its tax preparation partner wanted to offer a product the bank deemed too risky.

Between 2004 and 2009, the two institutions were subject to annual risk management examinations and two compliance examinations. The examinations identified repeated weaknesses in risk management practices. Both banks' RAL programs experienced heavier than normal losses in 2007. Examinations in 2008 showed continuing weaknesses in risk management practices and board and senior management oversight, and both institutions' compliance ratings were downgraded to less-than-satisfactory levels. Examinations in 2009 showed continued weaknesses in risk management practices and oversight, and both institutions were downgraded to an unsatisfactory level for compliance and "Needs to Improve" for CRA.

By December 2009, FDIC continued to have a variety of concerns with the RAL programs of both institutions. One of the institutions had moved the RAL business to an affiliate for the 2009 tax season and was not in compliance with a February 2009 Cease and Desist Order requiring enhancement of its program oversight. Later, that institution entered into contracts to expand its ERO lender base without the required prior notice to the FDIC.

Another institution was operating under a Memorandum of Understanding (MOU) requiring it to improve its oversight, audit, and internal controls over its RAL business. The bank's management was not in compliance with those provisions of the MOU.

Given identified risk management weaknesses and concerns about one institution's continued expansion, in December 2009, FDIC directed the institution to deliver a plan to exit the RAL business. Based on similar concerns with another bank's risk-management weaknesses, and reports that the Internal Revenue Service was contemplating discontinuance of its Debt Indicator, a key underwriting tool for RAL lending, FDIC sent similar letters to two other banks in February 2010, requesting that they develop and submit plans to exit the RAL business.

The letters sent to all three of the banks expressed concern about the utility of the product to the consumer given high fees. This concern was consistent with the FDIC's Supervisory

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Policy on Predatory Lending, which stated that signs of predatory lending included, among others, the lack of a fair exchange of value. All three institutions declined the request that they develop a plan to exit the business.

FDIC had Operative Guidance for Banks Engaged in RALs

The Draft Report suggests that the FDIC did not have guidance that was applicable to RALs. In fact, the FDIC has well-established guidance for the supervision of banks that offer RALs, stemming from longstanding guidance governing predatory lending as well as guidance for banks engaged in third-party lending arrangements.

In June 2006, the OIG's Audits and Evaluations staff issued OIG Report 06-011, *Challenges and FDIC Efforts Related to Predatory Lending*. The Report recommended that FDIC issue a policy on predatory lending, and FDIC complied. The Policy, which was issued in January 2007, states, "[s]igns of predatory lending include the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a borrower represents or other customary standards."[3] Further, FDIC issued FIL-44-2008, *Guidance for Managing Third-Party Risk,* in June 2008. Both pieces of guidance were relevant to the banks engaged in the RAL business.

Headquarters Management Properly Oversaw Regional Offices

The Draft Report suggested that decisions by FDIC officials to change draft ratings assigned by examiners were improper and unfounded. However, such oversight is appropriate and the review of the examination documents suggests the changes had a strong supervisory basis.

In 2010, FDIC headquarters instructed the [redacted] Regional Office to consider bank practices, not just their current financial conditions, in assigning ratings to two banks with identified weaknesses in their RAL programs. This instruction was consistent with interagency rating guidelines. The instruction was also consistent with the concept of forward-looking supervision that the FDIC had emphasized in response to OIG recommendations following Material Loss Reviews of failed banks.

Forward-looking supervision encourages examiners to consider the fact that even financially strong institutions can experience stress in cases in which risks are not properly monitored, measured, and managed. Further, examiners are encouraged to take proactive and progressive action to encourage banks to adopt preemptive measures to address risks before their profitability and viability is impacted.

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[3] See https://www.fdic.gov/news/news/financial/2007/fil07006.html, FDIC Financial Institution Letter 6-2007, FDIC's Supervisory Policy on Predatory Lending, January 22, 2007.

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The ratings for the two banks were fully supported by the weaknesses identified in both banks' risk management practices and board and senior management oversight of their RAL businesses.

Supervisory Practices were Appropriate and Risk-Focused, Consistent with Longstanding Policy

During 2010, FDIC's concerns about the safety and soundness of RAL programs grew. OCC and OTS had each directed a large institution to exit the RAL business, and an additional large financial institution exited the RAL lending business on its own. The FDIC was concerned that the activities would migrate to the three FDIC supervised community banks, two of which had documented weaknesses in the oversight of their existing RAL programs. Further, the IRS announced in August it would discontinue the Debt Indicator (DI) before the 2011 tax season; the DI had proven to be a key tool for reducing credit risk in RALs. In November 2010, the institutions were asked to outline their plans for mitigating the resulting increase in credit risk following the loss of the tool. All three institutions conceded that the loss of the DI would result in increased risk to their banks. Despite these concerns, all three institutions continued to decline to exit the business. Finally, in December 2010, OCC directed the final national bank making RALs to exit the business before the 2011 tax season.

In response to these concerns, as well as the ongoing compliance issues that were being identified by 2010 risk-management examinations, the FDIC planned to conduct unannounced horizontal reviews of EROs during the 2011 tax season. These types of reviews were not a novel supervisory tool for the FDIC; in fact third-party agents of one of the institutions had previously been the subject of a horizontal review in 2004 that covered two additional FDIC-supervised institutions.

The 2011 horizontal review ultimately only covered EROs of one of the banks. The review confirmed that the institution had violated law by interfering with the FDIC's review of the EROs during the 2009 compliance examination and during the 2011 horizontal review by coaching ERO staff and providing scripted answers. The review identified a number of additional violations of consumer laws and unsafe and unsound practices, violations of a Consent Order, and violations of Treasury regulations for allowing third-party vendors to transfer up to 4,300 bank accounts for Social Security recipients without the customers' knowledge or consent.

FDIC's Enforcement Actions Were Legally Supported

Contrary to what the Draft Report suggests, the presence of litigation risk does not mean an enforcement action has no legal basis. While some in the Legal Division – in particular the Deputy General Counsel, Supervision Branch (DGC) – believed that enforcement action against one institution presented litigation risk, the General Counsel and the DGC both approved the enforcement actions taken by the FDIC. Their own actions demonstrated their belief that the enforcement action was legally supportable.

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The decision to pursue an enforcement action against the bank despite the presence of litigation risk is consistent with guidance offered by the OIG. In a 2014 report on enforcement actions, the OIG noted that legal officials need to ensure that their risk appetite aligns with that of the agency head and should clearly communicate the legal risks of pursuing a particular enforcement action, but the agency head or senior official with delegated authority should set the level of litigation risk that the agency is willing to assume.

Moreover it is important to note that experienced enforcement counsel and subject matter experts in the Legal Division reviewed and responded to the concerns raised by the [redacted] Regional Counsel in a series of memoranda.

Communications Between FDIC Board Members and Staff Were Appropriate

The Draft Report suggests that discussions between staff and FDIC Board members on the RAL programs were unusual and inappropriate. However, as discussed below, such discussions are expected and appropriate. No member of the FDIC Board directed FDIC staff to order any banks to discontinue offering RAL products or to take any action that was not supported by supervisory findings.

The FDIC bylaws set forth the organizational structure of the FDIC and the foundation for communications and exercise of authority of both the FDIC Board and its Officers. The FDIC Board has overall responsibility for managing the FDIC, while day-to-day responsibility for managing the FDIC and supervising its Officers is delegated to the FDIC Chairman. FDIC Officers have a duty to keep the Chairman informed of their actions as well as other Board members as appropriate, and they meet this duty through regular briefings of the Chairman and updates to other Board members about the ongoing activities in their organizations.

Case Review Committee Acted Consistently With Existing Guidelines

Contrary to the suggestion in the Draft Report, the Case Review Committee (CRC) acted consistently with existing guidelines in connection with the issuance of the Notice of Charges against an institution in February 2011. The CRC is a standing committee of the FDIC Board of Directors that is responsible for overseeing enforcement matters. Its voting members consist of one internal FDIC Board member who serves as the CRC Chairman and one special assistant or deputy to each of the other four FDIC Board members.

First, the Notice of Charges sought a Cease & Desist Order (C&D) which does not require CRC approval under governing documents. Authority to issue C&D Orders was delegated to staff and therefore the CRC was not required to vote on the C&D Order.

Second, CRC governing documents provide for staff to consult with the CRC Chairman if a proposed enforcement action may affect FDIC policy, attract unusual attention or publicity, or involve an issue of first impression. Under such circumstances, the CRC Chairman may, in his or her discretion, determine whether review and approval by the CRC would be desirable, in

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which case the matter would be heard by the CRC. Thus, the Notice of Charges did not require a CRC vote.

Finally, CRC governing documents provide that the CRC Chairman is expected to take an active role in the enforcement process and to meet regularly with senior supervision and legal enforcement personnel to review enforcement activities and matters. As such, it was wholly permissible and appropriate for the CRC Chairman to engage with staff in active debate over a matter affecting the FDIC.

Settlement Discussions Were Handled Properly

The FDIC acted consistently with outstanding agency policy when conducting settlement discussions. In the case referenced by the OIG, the bank was prevented from participating in failed bank acquisitions by two issues: an outstanding enforcement action and compliance and risk-management problems stemming from its RAL program. Once the bank settled its enforcement action and agreed to exit the RALs business, there was no reason to prevent the bank from qualifying for the "failed bank bid list." To do otherwise could have been arbitrary and unduly punitive.

Conclusion

The FDIC had longstanding supervisory histories with respect to RALs. To differing degrees, the institutions engaged in the RAL business had a record of supervisory deficiencies identified by examination staff in both risk management and compliance stemming from their RAL programs. These issues formed the basis for the examination and enforcement actions described in the report. Nonetheless, the Draft Report did identify areas where better communication, both internally and externally, could have improved understanding of the agency's supervisory expectations and bases for action. Additionally, the Draft Report describes at least one instance in which a former employee – new to the FDIC at the time[4] – communicated with external parties in an overly aggressive manner. The FDIC does not condone such conduct, that type of conduct is not consistent with FDIC policy, and steps were taken to address the conduct at the time.

We look forward to reviewing the details of the final report and will provide actions to be taken in response within the 60-day timeframe specified by the OIG.

[4] The employee left the agency later that same year.

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FDIC RESPONSE TO THE DRAFT REPORT OF INQUIRY INTO THE FDIC'S SUPERVISORY APPROACH TO REFUND ANTICIPATION LOANS AND THE INVOLVEMENT OF FDIC LEADERSHIP AND PERSONNEL

Introduction

The Draft Report presented the OIG's view of the FDIC's handling of its supervisory responsibilities with respect to three financial institutions that offered RALs between five and eight years ago. We reviewed the materials relied upon by the OIG, which included select email communications between FDIC employees, one former employee's personal notes, draft and final reports of examination, and information from interviews that OIG staff conducted with select past and current FDIC personnel. After reviewing relevant materials, we believe that the supervision and enforcement activities that occurred with respect to the three banks discussed in the Draft Report were supported by the supervisory record and handled in accordance with FDIC policy. Nonetheless, the Draft Report did identify areas in which better communication, both internally and externally, could have improved understanding of the agency's supervisory expectations and bases for action. Additionally, the Draft Report describes at least one instance in which a former employee – new to the FDIC at the time[5] - communicated with external parties in an overly aggressive manner. The FDIC does not condone such conduct, that type of conduct is not consistent with FDIC policy, and steps were taken to address the conduct at the time. We look forward to reviewing the details of the final report and will provide actions to be taken in response within the 60-day timeframe specified by the OIG.

Refund Anticipation Loans

RALs are short-term, high-interest bank loans that are advertised and brokered by both national chain and local tax preparation companies.[6] In a RAL, the taxpayer's anticipated income tax refund serves as both collateral and the expected source of repayment.[7] The taxpayer borrows against all or part of the expected refund and is responsible for paying the loan in full, no matter how much of the anticipated refund is ultimately approved and released by the Internal Revenue Service (IRS).[8] Financial institutions (banks) issue RALs, but commercial tax preparation businesses facilitate or broker the products.[9] This arrangement, where a third party acts as intermediary between the bank and the borrower, is an important distinction between RALs and more conventional loan products. By their very nature, third-party lending arrangements give rise to certain risks (which this response describes in further detail) that are not present in other types of loans.

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[5] The employee left the agency later that same year.

[6] United States Government Accountability Office Report, GAO-08-800R Refund Anticipation Loans (June 5, 2008) (stating "the annual percentage rate (APR) on RALs can be over 500 percent").

[7] The National Taxpayer Advocate's 2007 Objectives Report to Congress, Volume II, *The Role of the IRS in the Refund Anticipation Loan Industry*.

[8] *Id.*

[9] *Id.*

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Before transferring any RAL proceeds to the taxpayer, the bank first deducts fees for the preparation and filing of the borrower's income tax return, as well as finance charges and processing fees for the loan itself. The taxpayer receives the balance of the refund by check, direct deposit, debit card, or as a down payment for goods or services. Once the IRS processes the return generating the refund, the IRS transfers the refund amount directly to the bank to repay the loan.[10]

Significant and long-standing concerns have been raised regarding RALs. In June 2006, the FDIC OIG's Audits and Evaluations staff issued OIG Report 06-011, *Challenges and FDIC Efforts Related to Predatory Lending.* That report cited research that found, "borrowers lose more than $25 billion annually due to predatory mortgages, payday loans, and lending abuses involving overdraft loans, excessive credit card debt, and ***tax refund loans*** (emphasis added)." The National Taxpayer Advocate, which is the government ombudsman for taxpayers, has reported that RALs are costly and have a disproportionate impact on taxpayers receiving the Earned Income Tax Credit, a benefit for working people with low to moderate income.[11] The National Taxpayer Advocate also expressed concerns about whether borrowers were being made fully aware of the costs involved in RALs and their tax filing alternatives. In January 2008, to address the concerns raised by the National Taxpayer Advocate, the IRS and the Department of the Treasury issued a *Federal Register* notice advising that they were considering rules to prohibit tax preparers from marketing RALs based on information gathered during the tax preparation process.[12]

Risks Associated with RALs

By their very nature, RALs carry a heightened level of credit, fraud, third-party, and compliance risk. Each of these risks must be properly identified and managed by the banks that choose to engage in these lending arrangements. To mitigate fraud, money laundering risk, and third-party risk, banks must execute strong oversight of the storefront tax preparers (also referred to as electronic refund originators (EROs)) that originate RALs. Similarly, the risks associated with the offering of the product require strong oversight by the supervisory authority to ensure that the bank is offering the product in a safe and sound manner and in compliance with applicable guidance and laws. Banks can be liable for violations of law by their third part agents. Fewer than 10 financial institutions have ever offered RALs.

Credit Risk

Credit risk for RALs stems in part from the fact that the loans are not underwritten with respect to any other source of repayment aside from the borrower's anticipated tax refund from the IRS. If all or part of the borrower's refund is encumbered by a tax lien or other offset, such as child

[10] *Id.*

[11] *Id.* at 3 and 4 and National Center for Consumer Law, Appendix A, RALs, Tax Fraud, and Fringe Preparers

[12] See Report Prepared by the Urban Institute for the Department of the Treasury, *Characteristics of Users of Refund Anticipation Loans and Refund Anticipation Checks* (2010).

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support payments, or if the borrower's tax return is not accurately filed, the bank will be exposed to these losses.

In the early 1990s the IRS provided the industry with a tool, which subsequently came to be known as the IRS Debt Indicator, which alerted lenders of potential offsets against tax refunds.[13] This enabled lenders to identify and manage some of the credit risk associated with RALs. The IRS ceased offering the tool for a period of time in the mid-1990s because of concerns about fraud in electronically filed tax returns with RALs.[14] As a result, RAL volume dropped, and RAL fees increased, demonstrating the substantial role that the Debt Indicator had in managing risk in RALs.[15] In 2000, the IRS reinstated the tool, and the number and volume of RALs originated grew substantially in the early 2000s.

Fraud Risk

In addition to credit risk, fraud has been identified as a risk associated with RALs. The Financial Crimes Enforcement Network (FinCEN), a division of the Treasury Department whose mission in part is to safeguard the financial system from illicit use and to combat money laundering, outlined known fraudulent schemes related to RALs in a report more than a decade ago.[16] For example, FinCEN found schemes in which people created fake tax return documents and then posed as individuals or business owners at tax preparers and obtained a RAL. In other schemes, employees at tax return preparers themselves filed fraudulent returns and collected the RALs.

FinCEN provided guidance for banks that included warning signs of fraud related to RALs, and reminded banks of legal requirements to file Suspicious Activity Reports.

Third-Party and Compliance Risk

Banks that make RALs also face significant third-party risk because the loans are not originated directly by the bank. Instead the loans are originated by hundreds or thousands of storefront tax preparation businesses throughout the country. In almost no instances are these loans made by trained loan officers. Nonetheless, as agents of the bank, errors made by these storefront tax preparers can subject the bank to violations of federal consumer protection laws governing privacy, marketing, and disclosure, some of which have disgorgement provisions that would require the repayment of improperly disclosed fees.

RALs that are originated by federally regulated financial institutions are subject to several federal consumer protection and anti-money laundering laws: the Truth in Lending Act, which requires lenders to disclose terms and conditions of loans, including the cost of a loan as

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[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] See https://www.fincen.gov/news_room/rp/files/sar_tti_07.pdf, Financial Crimes Enforcement Network, "Refund Anticipation Loan Fraud." *SAR Activity Review: Trends, Tips & Issues*, issue 7, pp 15-20 (August 2004).

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an annual percentage rate; the Equal Credit Opportunity Act, which prohibits discrimination in the offering of credit on the basis of race, color, sex, age, religion, national origin or marital status, among others and requires lenders to provide a clear basis for the denial of credit to the applicant; the Fair Credit Reporting Act, which promotes the accuracy, fairness and privacy of information in the files of consumer reporting agencies; the Fair Debt Collection Practices Act, which provides guidelines and limitations on the conduct of third-party debt collectors and creditors in the collection of consumer debts; the Privacy Act, which requires the lender to secure the taxpayer's written consent to provide tax information to the lender; the Bank Secrecy Act, which requires institutions to comply with anti-money laundering, customer identification and record-keeping requirements; and Section 5 of the Federal Trade Commission Act, which prohibits the use of unfair or deceptive acts or practices in connection with any consumer financial product or service.

Bank-issued RALs are also governed by the interagency guidelines establishing standards for safeguarding customer information[17] issued by the banking agencies pursuant to the Gramm-Leach-Bliley Act and the interagency guidelines establishing standards for safety and soundness[18] issued by the banking agencies pursuant to the Federal Deposit Insurance Corporation Improvement Act as amended by the Riegle-Neal Act. Finally, certain RALs are subject to the Military Lending Act, which restricts the interest and other terms that can be offered to active duty military personnel and their spouses and dependents; and the Servicemembers Civil Relief Act, which limits interest rates for active duty military personnel.

FDIC's Supervisory Process

As primary federal supervisor for most community banks in the United States and as insurer for all insured depositories, the FDIC seeks to maintain a vigilant, but balanced posture with regard to both safety and soundness and consumer compliance supervision. Such an approach is in keeping with the longstanding principle that consumer protection and safe-and-sound banking are both important to the regulatory view of a bank's condition. This principle is also reflected in the Uniform Financial Institution Rating System (UFIRS) implemented by the Federal Financial Institutions Examination Council (FFIEC) in 1979 and updated in 1997. The UFIRS sets a standard for the FFIEC members to assign component ratings (commonly known as CAMELS) and composite ratings. This interagency bank rating system requires the agencies to consider an institution's consumer compliance, among other factors, in assigning component and composite ratings in safety and soundness examinations, also referred to as risk-management examinations. The most important element of prudential bank supervision is on-site examination activity.

[17] See https://www.fdic.gov/news/news/financial/2001/fil0122.html, *Guidelines Establishing Standards for Safeguarding Customer Information*, February 1, 2001.

[18] See https://www.fdic.gov/news/news/financial/1995/fil9549.html, *Guidelines and Compliance Procedures Issued; Request for Additional Comments Sought*, July 31, 1995 and https://www.fdic.gov/news/news/financial/1996/fil9679.html, *Interagency Guidelines Establishing Standards for Safety and Soundness to Include Final Asset Quality and Earning Standards*, October 4, 1996.

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The FDIC's Division of Risk Management Supervision (RMS) takes many steps to ensure that its on-site examination activity is carried out consistently and that the findings of examinations are presented in a manner that is consistent with FDIC rules and regulations, policies, and procedures. For example, each report of examination goes through at least one level of review by a case manager, who is trained to conduct those reviews and ensure that reports of examination are consistent with FDIC policy. In the case of more complex or troubled institutions, a report of examination goes through additional levels of review by an assistant regional director, deputy regional director or regional director. In the case of problem banks (those rated CAMELS 4 or 5) an additional review is completed by RMS staff in Washington. Each region's adherence to FDIC policy is reviewed on a tri-annual basis by a team of subject matter experts in Washington. The FDIC additionally uses management information tools to identify potential inconsistencies in its programs and emerging trends. These include monitoring the time between when an examination is started and when examination findings are delivered to a bank's board, monitoring trends in CAMELS ratings for the industry over time, and monitoring differences in examination ratings across disciplines. These processes are critical to ensuring consistent and effective supervision across the more than 6,000 institutions that the FDIC insures.

Guidance Issued in Response to Industry Innovation, OIG Recommendations, and Changing Conditions

The Draft Report suggests that the FDIC did not have guidance that was applicable to RALs. In fact, the FDIC has well-established guidance for the supervision of banks that offer RALs, stemming from long standing guidance governing predatory lending as well as guidance for banks engaged in third-party lending arrangements. The FDIC's supervisory focus on the risks posed by financial institutions originating loans through third parties is consistent with the longstanding principle illustrated in the UFIRS that safety and soundness and consumer protection are both important to the regulatory view of the condition of a given institution. The rapid growth of subprime consumer lending activity in the late 1990s led to the development by the FDIC and the other banking agencies of subprime lending guidance.[19] Additionally, legislation called for the agencies to issue guidelines establishing standards for safeguarding customer information.[20] This interagency guidance articulated safety and soundness and consumer protection concerns and were relevant to RAL lending.

As discussed earlier, in 2006, the FDIC OIG's Audits and Evaluations staff referenced tax refund loans in its OIG Report 06-011, *Challenges and FDIC Efforts Related to Predatory Lending*. The report cited challenges associated with identifying, assessing, and addressing the risks posed to institutions and consumers by predatory lending. Specifically, (1) each loan

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[19]See https://www.fdic.gov/news/news/financial/1997/fil9744.html, Risks Associated with Subprime Lending, Mary 2, 1997; https://www.fdic.gov/news/news/financial/1999/FIL9920a.html, *Interagency Guidelines on Subprime Lending*, March 1, 1999; and https://www.fdic.gov/news/news/financial/2001/fil0109.html, *Expanded Guidance for Subprime Lending Programs*, January 31, 2001.
[20] See https://www.fdic.gov/news/news/financial/2001/fil0122.html, *Guidelines Establishing Standards for Safeguarding Customer Information*, February 1, 2001.

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transaction must be viewed in its totality to determine whether it may be predatory; (2) FDIC-supervised institutions can have direct or indirect involvement in predatory lending; and (3) nontraditional mortgages and other loan products are now available that contain terms that may be viewed as appropriate for some borrowers but predatory for others.

In its 2006 report, The OIG acknowledged that FDIC had taken efforts to address the challenges by providing guidance in various forms to examiners, FDIC-supervised institutions, and consumers. However, the OIG noted that the guidance did not formally articulate the agency's overall supervisory approach for addressing predatory lending. Instead, the FDIC's approach was comprised of multiple policies, procedures, and memoranda and the guidance was not issued for the explicit purpose of addressing predatory lending. As a result, OIG expressed concern that predatory lending may not receive sufficient attention, which increased the risk that such practices could occur, may not be detected, and may harm institutions and borrowers.

The OIG recommended that the FDIC's Division of Supervision and Consumer Protection (DSC – the predecessor to RMS and the Division of Depositor and Consumer Protection (DCP)), describe the FDIC's overall supervisory approach to predatory lending and review existing examiner, financial institution, and consumer guidance and determine whether additional guidance was needed to address the risks associated with predatory lending.

In response to the OIG's recommendation, on January 22, 2007, DSC issued Financial Institution Letter (FIL) 6-2007, *FDIC Supervisory Policy on Predatory Lending*, to describe certain characteristics of predatory lending, and reaffirm that such activities are inconsistent with safe and sound lending and undermine individual, family and community economic well-being. The policy describes the FDIC's supervisory response to predatory lending, including a list of policies and procedures that relate to consumer lending standards. Finally the Policy sets forth FDIC's expectation that the institutions it supervises treat consumers fairly, adhere to all applicable legal requirements, and underwrite loan products appropriately.

The policy states, "[s]igns of predatory lending include the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a borrower represents or other customary standards. Furthermore, as outlined in the interagency *Expanded Examination Guidance for Subprime Lending Programs*, 'predatory lending involves at least one, and perhaps all three, of the following elements:

- Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
- Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced ("loan flipping"); or
- Engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower.'"

On January 23, 2007, DSC issued Regional Director Memorandum (RD Memo) 2007-01, *Supervisory Policy on Predatory Lending*, to describe the principal characteristics of predatory lending and the FDIC's multi-pronged approach to addressing the problem by taking supervisory

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action, by encouraging and assisting banks to serve all sectors of their community, and by providing consumers with information to help make informed financial decisions. The RD Memo states, "[p]redatory loans, whether small dollar unsecured credit or residential mortgages, are inconsistent with safe and sound lending and undermine individual, family and community economic well-being."

FDIC and DSC took a number of additional steps consistent with the principles outlined in the guidance and in response to ongoing concerns regarding the risks of predatory loan products being offered to consumers through third parties. For example, DSC sought to strengthen supervisory oversight of third-party consumer lending arrangements. On June 6, 2008, the FDIC issued FIL-44-2008, *Guidance for Managing Third-Party Risk.* This guidance sought to ensure that financial institutions were aware of the potential risks arising from arrangements with third parties, including those in which the institution funded certain products originated by a third party. The guidance outlined risk-management principles that may be tailored to suit the complexity and risk potential of a financial institution's significant third-party relationships.

DSC also sought to bridge the gap between the compliance and risk management examination functions to ensure that there was consistent communication and follow-up about potential concerns across the two supervisory disciplines. The division established criteria for joint exams between the two disciplines, known as Joint Examination Team, or "JET."[21] In late 2007 or early 2008, [redacted], [redacted], was selected for a JET review to ensure a full understanding from both a risk management and consumer protection standpoint of the bank's use of third parties to conduct significant lending activities. The FDIC's supervision of [redacted] will be discussed in more detail later.

FDIC's Supervision of RALs Banks and use of an Incremental Approach

The Draft Report suggests that actions taken by the FDIC represented a sharp and rapid escalation in oversight of the institutions with RAL programs. The supervisory record, however, indicates that concerns were raised about risk-management oversight of the RAL programs at the institutions for a number of years. The oversight of the institutions and their RAL programs is described below. For a more complete history, please see Appendix A.

Prior to 2003, the FDIC supervised two institutions with RAL programs: [redacted] which in 2003 had [redacted]; and [redacted] with [redacted] At that time, [redacted] partnered with approximately 900 independent tax preparers that were acting as EROs to market the bank's products exclusively. [redacted] partnered with approximately 5,600 EROs through a bank subsidiary. The FDIC's experience with banks offering RALs expanded in 2003. [redacted]

[21] The JET was discussed in DSC's Supervisory Insight journal in the Summer of 2007 and subsequently in the FDIC's 2007 and 2008 Annual Reports.

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[redacted] which had [redacted] had an established RAL business and converted to a state nonmember charter, thus coming under FDIC supervision. FBD partnered with 342 EROs at the time of its conversion to FDIC supervision.

Further in 2003, [redacted] had just undertaken a rapid expansion of its program, growing the number of EROs by [redacted] percent in 2001 and [redacted] percent in 2002. In 2004, FDIC examiners identified weaknesses in program oversight at Republic and FBD, and violations of the Equal Credit Opportunity Act (ECOA) at [redacted] management disagreed with the ECOA violations and appealed the findings of the examination to the Acting Division Director. The Director upheld the examiner findings and rating.

FBD ultimately exited the RAL business in July 2006, because the third-party through which it originated RALs, [redacted], desired to issue paystub loans, a loan based on an estimate of a tax refund based on the borrower's year-end pay stub. FBD determined this loan product was too risky, and [redacted] canceled its contract with FBD. [redacted] business was subsequently acquired by [redacted], which was supervised by the Office of the Comptroller of the Currency (OCC). [redacted] and [redacted] continued to offer RALs. Over the course of the next six years, risk-management and compliance deficiencies were not fully addressed, and regulatory violations at both banks continued, culminating in both banks exiting the RAL business in 2012.

Supervisory History of Republic

Between 2004 and 2009, [redacted] was subject to annual risk-management examinations and two compliance examinations. The RAL program expanded rapidly during this period, with the number of EROs nearly doubling to over 10,000. This growth was not preceded by expanded controls and oversight, resulting in supervisory concerns being expressed in both the 2008 and 2009 risk-management and compliance examinations. Through its written disagreements with cited violations, [redacted] management demonstrated a lack of understanding of its responsibility for the actions of the EROs through which it was originating credit.

[redacted] management made unsuccessful efforts to change its federal supervisor through a merger of the bank with its affiliated thrift, and was reported to have made inquiries to the Federal Reserve about converting to a state member charter. The effect of either of these transactions, if consummated, would have been to remove [redacted] from FDIC supervision. [redacted] management was also suspected of seeking to address training deficiencies by coaching EROs to give satisfactory answers to examiners rather than by training the EROs to originate loans in compliance with law and guidance. These suspicions were confirmed in a 2011 horizontal review of the institution. The 2009 risk-management composite rating was [redacted] unchanged from the prior exam, with a management component rating of [redacted], a downgrade from a [redacted] in the prior exam. The 2009 compliance examination composite rating was [redacted], a downgrade from a [redacted], with CRA rated "[redacted]", a downgrade from "[redacted]" in the prior exam.

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Supervisory History of River City

Between 2004 and 2009, [redacted] was subject to annual risk-management examinations and two compliance examinations and one compliance visitation. The examinations identified a poor control environment with no audit of the RAL program, limited due diligence of EROs and poor board and senior management oversight of the program. Examiners cited contraventions of policy for the lack of an audit program at four consecutive examinations during this period. Management was characterized as nonresponsive and over-reliant on the honesty of the ERO. As such, the RAL program was especially susceptible to fraud. The bank experienced two ERO frauds and was the subject of two lawsuits regarding the program. The 2009 risk-management composite rating was [redacted] an upgrade from a [redacted] in the prior examination as a result of improved performance in unrelated bank activities, and the management component rating was unchanged at a [redacted]. The 2009 compliance examination composite rating was [redacted] a downgrade from a [redacted], with CRA rated "[redacted]," also a downgrade from "[redacted]"

[redacted]

[redacted] RAL program was first examined by the FDIC at the 2010 compliance examination and the 2011 risk-management examination. The compliance examination cited deficiencies in board and senior management oversight of the RAL program and assigned a rating of [redacted]. The risk management examination noted the bank had agreed to exit the RAL business. The bank was rated a [redacted] for other asset quality deficiencies.

Issuance of Letters to [redacted], and [redacted]

In July 2009, FDIC discovered that [redacted] had moved the RAL origination business to its sister thrift for the first quarter 2009 tax season, yet was still retaining the credit risk by simultaneously purchasing the loans and providing other services. This could have had the effect of making the RAL origination activity not subject to FDIC supervision or the requirements of the Cease and Desist Order, even though Republic was exposed to the risk of the RAL business. [redacted] ultimately shared origination documentation with FDIC, which resolved questions about how [redacted] would demonstrate compliance with the outstanding Cease and Desist Order. Subsequently, [redacted] was directed to advise the [redacted] of any material changes in business plan. However, Republic did not follow that instruction when it executed contracts to expand the business with [redacted] and another tax preparation business, Liberty. Rather, [redacted] notified FDIC of its assumption of this business after-the-fact on December 29, 2009. Given the bank's record of risk management and compliance problems and the fact that the bank was still operating under the C&D, the [redacted] directed the bank, in writing, to submit a plan within 15 days to exit the RALs business within 60 days. A second letter was issued the next day to require that a meeting be scheduled within 60 days to discuss the future viability of the program.

In February of 2010, against the backdrop of the growing supervisory concerns, the removal by the IRS of the Debt Indicator that was used to underwrite RALs, and the concern that

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RAL activities that were being exited by large institutions would migrate to the FDIC-supervised community banks, the [redacted] sent letters to [redacted] and [redacted] regarding their RAL programs. The February 3, 2010, letter sent to [redacted] detailed the concerns that the Region had with RALs and referenced a January 19, 2010, discussion in which those concerns were brought to the bank's attention. The February 3, 2010, letter to [redacted] outlined similar concerns and referenced a January 11, 2010, discussion with the bank in which those concerns were expressed. The letters stated that the Region found RALs were costly and offered limited utility for consumers as compared to traditional loan products. The letter further observed that RALs carried a high degree of risk to the institutions, including third party, reputational, compliance, and legal risk, which exposed the banks to individual and class actions by borrowers and local regulatory authorities. As a result, the Region asked the banks to develop plans to exit the business and submit plans to do so within 15 days.

In addition to a reflection of specific supervisory concerns, the concerns with the RAL product expressed in the letters also were consistent with the FDIC's Supervisory Policy on Predatory Lending. The policy states that "[s]igns of predatory lending include the lack of a fair exchange of value or loan pricing that reaches beyond the risk that a borrower represents or other customary standards."

Downgrades of Certain Ratings in 2010 Examinations Were Appropriate

The Draft Report suggested that decisions by FDIC officials to change draft ratings assigned by examiners were improper and unfounded. However, such oversight is appropriate and a review of the examination documents indicates the changes had a strong supervisory basis. Please see Appendix B.

As noted earlier, in the section, *FDIC's Supervisory Process*, the FDIC's Division of Risk Management Supervision takes many steps to ensure that its on-site examination activity is appropriately carried out and that the findings of examinations are presented in a manner that is consistent with FDIC rules and regulations, policy and procedures. Among those steps is a review of each report of examination by a professionally trained case manager. The FDIC's processes anticipate that findings or report commentary may on occasion require editing and change. For this reason, the FDIC *Risk Management Manual of Examination Policies* states: "[g]enerally, the examiner-in-charge (EIC) should discuss the recommended component and composite ratings with (the bank's) senior management and, when appropriate, the (bank's) board of directors, near the conclusion of the examination. Examiners should clearly explain that their ratings are tentative[22] and subject to the review and final approval by the regional director or designee."

When changes are made to ratings or substantive changes to report commentary are made during the review process, such changes should be fully communicated to the examiner-in-

[22] See FDIC *Risk Management Manual of Examination Policies, Basic Examination Concepts and Guidelines* section, page 1.1-3.

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charge. To the extent the examiner-in-charge disagrees with the changes, processes exist to document those disagreements. In 2010, when changes were made to the ratings at [redacted] and [redacted] examiner disagreements were not properly documented. Notwithstanding this oversight, the report changes were appropriate, supported by the examination record, and consistent with the UFIRS.

[redacted] *Downgrade*

The tentative ratings assigned by the examiner at the August 30, 2010 risk management examination of [redacted] were 112112/2. During the regional office review process, the rating was downgraded to 113222/3. The final Management, Earnings and Liquidity component and the composite ratings assigned at the August 30, 2010, risk management examination of [redacted] were accurate, supported by the examination record, and consistent with the definitions in UFIRS.

Bank management's abilities are measured not only by financial performance, but also by its ability to operate within governing regulations, its responsiveness to recommendations from auditors and supervisory authorities, and to properly oversee all business line risks. The final report of examination properly concluded that management and board performance needed to improve their oversight of the bank's activities. Pronounced shortcomings relating to compliance with laws and regulations existed. In addition, management's expansion of activities that were not appropriately identified, measured, monitored, and controlled raised supervisory concerns. Accordingly, management and board performance were more accurately characterized as needing improvement, supporting a Management component rating of [redacted]

Earnings strength is measured not only by the quantity and trend of earnings but also by factors affecting the sustainability or quality of those earnings. The income stream derived from the bank's Tax Refunds Solution (TRS) program, which included RALs and was significant, was expected to be impacted by events that were beyond Management's control. Due to reliance on the TRS income, any depletion would affect the Bank's operations. The bank's reported earnings did not account for the unrecognized costs to conform its business practices to laws and regulations. In view of these facts, the stability and quality of earnings are more accurately characterized as satisfactory rather than strong, supporting an Earnings component rating of [redacted]

In evaluating a financial institution's liquidity, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. Funds management practices should ensure that liquidity is not maintained through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. In view of the institution's reliance on brokered funding for funding some of its growing activities, which may not be available in a time of financial stress or adverse changes in market conditions, the liquidity rating of [redacted] was appropriate.

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Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. In light of the noncompliance with a key provision in the outstanding cease and desist order related to inadequate board participation in the activities of the bank, the bank was determined to need more than normal supervision, in the form of an amended cease and desist order, supporting the [redacted] rating assigned.

[redacted] *Downgrade*

The tentative ratings assigned by the examiner-in-charge of the October 25, 2010 risk management examination of [redacted]ty were [redacted] During the regional office review process, the case manager downgraded the rating to [redacted] The examiner-in-charge agreed with these changes. The final rating assigned was [redacted] which more clearly reflected the many management deficiencies and elevated risk profile of [redacted] The final Management component and the composite ratings assigned at the October 25, 2010 risk management examination of [redacted] were accurate, were supported by the examination record, and were consistent with the definitions in UFIRS.

Management's abilities are measured not only by financial performance, but also by its ability to operate within governing regulations, its responsiveness to recommendations from auditors and supervisory authorities, and to properly oversee all business line risks. The final report of examination properly concluded that management and board performance needed to improve risk oversight as it pertained to non-traditional products. Management oversight of RALs and the bank's Dollars Direct program was described as ineffective, and management's lack of adequate internal controls and audit reviews were cited as a concern, both of which exposed the bank to heightened third-party risks. Capital, asset quality, earnings and liquidity were described as satisfactory, but subject to potential impact from risks associated with the non-traditional banking products. Accordingly, management and board performance and risk management practices were more accurately characterized as deficient than needing improvement, supporting a Management component rating of [redacted]

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a

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composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. The unsatisfactory board and management oversight of and lack of controls around the most significant business product for the bank, in terms of its net income and potential fraud exposure, were accurately characterized as serious deficiencies, supporting the composite rating of [redacted]

FDIC's Senior Management Properly Oversaw Policy Implementation

As the 2010 examinations of [redacted] and [redacted] were concluding, DSC management discussed the region's findings, including the examination ratings, with the [redacted] Regional Director (RD). The DSC Senior Deputy Director (SDD) specifically instructed the RD to ensure staff considered the banks' practices, not just their current financial conditions, in assigning ratings.

This instruction was consistent with the UFIRS, which requires consideration of management's ability to identify, measure, monitor, and control the risks of its operations when assigning each component rating. The UFIRS recognizes that appropriate management practices vary considerably among financial institutions, depending on their size, complexity, and risk profile. For less complex institutions engaged solely in traditional banking activities, relatively basic management systems and controls may be adequate. At more complex institutions, on the other hand, detailed and formal management systems and controls are needed.

Consistent with the UFIRs, the risk management expectations for banks lending through hundreds or thousands of EROs would clearly be higher than the expectations for community banks engaged in traditional lending activities. This expectation was additionally the subject of the FDIC's *Guidance on Managing Third-Party Risk*.

The instructions of the SDD were also consistent with the principle behind the concept of forward-looking supervision that the Division had emphasized in response to OIG findings from Material Loss Reviews of failed banks.

Forward-Looking Supervision

In response to recommendations by the OIG[23] and employing lessons from the financial crisis, the FDIC had taken a series of steps aimed at emphasizing the importance of having effective risk-management practices in place to mitigate the effects of economic and marketplace changes not within a bank's control.[24] The process encourages examiners to consider the fact that even financially strong institutions can experience stress in cases where risks are not

[23] See Memorandum from Inspector General Jon T. Rymer to the FDIC Audit Committee, Material Loss Review Observations Related to Major Causes, Trends, and Common Characteristics, May 1, 2009.

[24] See FDIC 2009 Annual Report, Appendix C, Office of Inspector General's Assessment of the Management and Performance Challenges Facing the FDIC, which states, "The Corporation has developed a comprehensive "forward-looking supervision" training program for its examiners designed to build on lessons learned over the past year or so and will need to put that training into practice going forward."

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properly monitored, measured, and managed. Further, examiners are encouraged to take proactive supervisory action and progressive action to encourage banks to take preemptive measures to address risks before their profitability and viability is impacted. Another important lesson from the crisis, as noted in an OIG evaluation, was that bank management's responsiveness to supervisory concerns was a key differentiating factor between banks that failed and those that survived the financial crisis.

Consistent with the UFIRS and the principles of forward-looking supervision, the RD instructed staff to lower the examiner-assigned ratings of the two institutions based on his conversations with the SDD. It does not appear that the RD explained the rationale for the downgrades to field staff, directly or indirectly through his regional managers. This may have contributed to the confusion identified in the OIG's Draft Report and the resulting misperceptions of the FDIC's supervisory approach to institutions that offer RALs.

Supervisory Practices Were Appropriate and Consistent with Past Practices

During 2010, DSC management's concerns about the safety and soundness of RAL programs grew, based in part on the fact that the IRS announced in August it would discontinue the Debt Indicator (DI), which had proven to be a key tool for reducing credit risk in RALs, in the 2011 tax season. In November 2010, the three institutions were asked to outline their plans for mitigating the resulting increase in credit risk following the loss of the tool. All three institutions conceded that the loss of the DI would result in increased risk to the bank.

[redacted] replied that it was in the process of finalizing its revisions to the RAL underwriting process for the upcoming tax season and had identified several significant changes that would strengthen RAL underwriting [redacted] intended to offer a reduced dollar RAL at a cost of $20 or less and lend only to consumers with a credit score of 650 or greater. While it appears that this underwriting would have complied with the interagency safety and soundness standards for credit underwriting, as previously described, [redacted] had long standing deficiencies in its RAL program, and examiners had made repeated recommendations over five examinations regarding needed audit and internal control improvements.[25] Ultimately, [redacted] agreed to exit its RAL program after the 2011 tax season during a meeting held with its board of directors on February 14, 2011, to discuss the findings of the FDIC's October 25, 2010, risk management examination.

[redacted] replied that since greater losses were anticipated absent the tool, loan amounts would be substantially cut by some 75 percent so that a profit could still be made. [redacted] also planned to use a commercial product that predicted the existence of government liens or debts. The institution acknowledged that the commercial product did not fully mitigate the risk created by loss of the DI. Additionally, the revised RAL model, which substantially reduced the amount of credit offered, served to emphasize the importance of the DI in RAL underwriting.

[25] See https://www.fdic.gov/regulations/laws/rules/2000-8630.html#fdic2000appendixatopart364, Appendix A to Part 364 of the FDIC Rules and Regulations, Interagency Guidelines Establishing Standards for Safety and Soundness.

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[redacted]'s board of directors indicated its intent to exit the RAL program in early February 2011.

[redacted] similarly replied that since greater losses were anticipated absent the tool, loan amounts would be substantially cut by some 75 percent, and fees increased so that a profit could still be made [redacted] also planned to use a commercial product (LexisNexis) that predicted the existence of government liens or debts. The institution acknowledged that the commercial product did not fully mitigate the risk created by loss of the DI. Additionally, the revised RAL model, which substantially reduced the amount of credit offered, served to underscore the importance of the DI in RAL underwriting. The model did not take into account the borrower's ability to repay, as required by interagency credit underwriting standards, and the new commercial product did not fully mitigate the loss of the DI, by the bank's own acknowledgement.

DSC Executives Properly Considered the Impacts of Industry Trends

FDIC institutions offering RALs were not the only banks affected by the loss of the DI. The Office of the Comptroller of the Currency (OCC) had similar communications with one of the banks it supervised, HSBC, about how it would underwrite RALs in a safe and sound manner absent the DI. [redacted] responded that it would no longer offer its RAL product that relied on the DI. Instead, it would only offer its Instant RAL product, which provided a smaller advance against the anticipated tax refund, effectively adopting the same approach suggested by the three FDIC supervised institutions by significantly decreasing the loan size. The OCC concluded that the Instant RAL was underwritten without consideration of the customers' ability to repay and was, therefore, not consistent with safe and sound banking practices. The OCC further noted that simply charging borrowers more fees for this type of loan was not a solution for the fundamental underwriting defect that would be present in the bank's remaining RAL business. On December 23, 2010, OCC accepted [redacted]'s plan to exit the RAL business on February 28, 2011.

Additionally, in 2010, other large banks exited the RAL business. [redacted] exited the RAL business in April 2010, citing increased regulatory scrutiny. [redacted] partnered with some 13,000 independent tax preparation partners.[26] Further, in October 2010, the Office of Thrift Supervision informed [redacted] that OTS was not prepared to allow [redacted] to enter into any new third-party relationships concerning any credit product, deposit product, or ATM pursuant to OTS supervisory directives.[27] [redacted] had contracted with [redacted] to originate a portion of its RAL business for the upcoming tax season. The directives essentially prohibited [redacted] from making RALs.

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[26] See http://www.woodstockinst.org/blog/2010/consumer-advocates-cheer-chase-exits-refund-anticipation-loan-business, Woodstock Institute, *Consumer advocates cheer as Chase exits refund anticipation loan business*, Rand (2010).

[27] See http://www.metafinancialgroup.com/Cache/10229685.pdf?IID=1027856&FID=10229685&O=3&OSID=9, [redacted] Inc., 8k, October 18, 2010.

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The exit of these three large financial institutions from the RAL origination business, and the possible migration of the business to the smaller, FDIC-supervised banks, raised concerns with FDIC senior management. Combined with the loss of the DI, the oversight weaknesses identified in examinations, and, in the case of [redacted] suspicions--that were later confirmed--that bank management had coached EROs to provide proper answers to examiner questions as to a heightening of supervisory concerns.

Horizontal Review Identifies Numerous Violations and Republic Management Attempts to Impede the Examination

The OIG in the Draft Report raises concerns that the FDIC used what it deemed was an abnormally large amount of resources in the supervision of RAL programs, suggesting unfairness in the oversight of the institutions with RAL programs. However, the practices employed by the FDIC were consistent with past work and commensurate with the scale of the banks' activity.

In response to the loss of the DI, as well as the ongoing compliance issues that were being identified by the 2010 risk-management examinations at [redacted] and [redacted], the FDIC planned to conduct unannounced horizontal reviews of the three RAL banks' EROs during the 2011 tax season. The [redacted] was already in the process of planning unannounced reviews of EROs of all three institutions under its supervision. Since these simultaneous reviews would allow the Region to compare practices across the three institutions EROs, they were horizontal reviews. Horizontal reviews were not a novel or new supervisory tool for the FDIC; in fact third-party agents of [redacted] had previously been the subject of a horizontal review in 2004 that covered three FDIC-supervised institutions, involved 40 third-party lenders, and required 120 examiner resources. The scale of the planned 2011 review was proportional to the large number of locations at which the RALs activities were taking place.

Owing to the widespread issues being identified, however, senior examination staff believed the program should be run on a national basis. The expanded review was necessary for two reasons. First, the banks under review engaged thousands of storefront EROs across the country. [redacted] alone made loans though more than 10,000 EROs, more offices making loans than Wells Fargo has branches.[28] As a result, in order to provide a valid statistical analysis whose results could be extrapolated to the universe of EROs for each bank, an expanded review would need to encompass a statistically valid number of EROs. This would enable supervision staff to gain an understanding of the compliance and safety and soundness practices of each bank as a whole. Second, there were outstanding concerns, expressed by examiners, that in prior reviews EROs were improperly coached by the banks.

The horizontal review was conducted on [redacted] and [redacted], and ultimately only covered [redacted] EROs, as [redacted] and [redacted] agreed to exit their

[28] See FDIC Summary of Deposits data, https://www5.fdic.gov/sod/sodInstBranch.asp?barItem=1

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RAL programs after the end of the tax season. The horizontal review confirmed that [redacted] interfered with the FDIC's review of the EROs during the 2009 compliance examination and during the ongoing horizontal review by coaching and providing scripted answers. The review also identified a number of additional violations of consumer laws, unsafe and unsound practices, and violations of the 2009 Consent Order.

Legal Issues were Carefully Considered, and Enforcement Proceedings against [redacted] were Fully Supported

The Draft Report suggests a number of legal concerns were raised about litigation risk in the supervision of [redacted] that were ignored by FDIC officials. In fact, each issue was weighed and considered, and the decision to move forward with an enforcement action was widely approved by the appropriate supervision and legal officials, including by an individual cited frequently by the OIG.

On February 9, 2011, the FDIC issued a Notice of Charges (Notice) against [redacted] Bank alleging safety and soundness violations as a result of inadequate underwriting for the Bank's RAL program. This action was not taken lightly. In the weeks and months leading up to the issuance of the Notice, staff engaged in vigorous and healthy debate as to whether there was sufficient legal support for the enforcement action to proceed.

On one hand, DSC officials were aware that [redacted] had self-certified that RAL underwriting was not as strong without the DI and that [redacted] said that it would need to offer significantly lower loan balances and charge higher fees to offset anticipated increased credit losses. This presented a new landscape – for the first time, the RAL product would not be profitable based on interest income minus charge offs. It was only the higher fees that would make the RAL product profitable. DSC staff viewed [redacted] plan to address the loss of the DI by reducing available credit and increasing fees as inherently unsafe and unsound. That view was coupled with concerns about asset-based lending and [redacted] refusal to consider an individual's ability to repay when issuing the loan, another unsafe and unsound practice.[29] Instead of adequately assessing a borrower's ability to repay, [redacted] focused on its ability to obtain a contingent asset – the tax refund. DSC staff was aware too that the OCC used this same analysis when it directed HSBC, one of its regulated banks, to exit the RAL business. Staff also questioned the relative utility of RALs in light of technological advances – by that point, direct deposit of electronic refunds usually occurred in a matter of days.

[29] Federal "standards for safety and soundness" require banks to follow loan documentation practices that "assess the ability of the borrower to repay the indebtedness in a timely manner," and underwriting practices that "[p]rovide for consideration, prior to credit commitment, of the borrower's overall financial condition and resources" as well as "the financial responsibility of any guarantor" and "the nature and value of any underlying collateral." Interagency Guidelines Establishing Standards for Safety and Soundness, 12 C.F.R. Part 364, App. A. Numerous courts have recognized that failure to assess ability to repay constitutes an unsafe and unsound banking practice. *See, Gulf Fed. Sav. & Loan Ass'n v. FHLBB*, 651 F.2d 259, 264 (5th Cir. 1981) (legislative history of section 1818(e) indicates that "disregarding a borrower's ability to repay" is an unsafe and unsound practice); *First State Bank of Wayne County v. FDIC*, 770 F.2d 81, 82 (6th Cir. 1985) ("extending secured credit without obtaining complete supporting documentation" constitutes unsafe and unsound practice).

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On the other hand, certain FDIC Enforcement attorneys, including the [redacted] expressed concern over reliance on elimination of the DI as the basis for safety and soundness violations and the lack of a readily identifiable witness on the issue who could testify to that effect should the matter come to litigation. To address these concerns, DSC officials, among other things, tasked FDIC retail credit experts in [redacted] with reviewing whether [redacted] plan to use the LexisNexis database as a substitute for the DI was an adequate underwriting tool. After reviewing this issue[30], the credit experts determined that the LexisNexis database did not sufficiently mitigate the underwriting risks posed by the loss of the DI.

The DGC also raised the issue of whether the underwriting procedures utilized by [redacted] were similar to the standards set forth in the FDIC's Small-Dollar Loan Pilot program. The DGC by his own admission did not fully analyze [redacted] underwriting or the particulars of the Small-Dollar Loan Pilot program in raising an issue that needed such analysis. Contrary to [redacted] underwriting procedures, the Small-Dollar Loan Pilot program recommended APRs no greater than [redacted] percent, noted the benefits of community based lending, and did not endorse a product whose profitability was based on fees. The APR for [redacted] RALs far exceeded [redacted] percent --when its higher fees were treated as "finance charges" under TILA, as case law suggests they should be.[31] [redacted] operated its RAL program through a network of more than 10,000 temporary tax offices spread throughout the country. It had no historical relationship with the vast majority of its customers. Nor did it operate in their communities, except through the EROs.

While the DGC continued to express concern as to whether the FDIC would prevail at trial based on safety and soundness charges, neither he -- nor any of the other FDIC officials who reviewed the proposed charges and recommended the issuance of the Notice – indicated a belief that the DI-based claims were not legally supportable. FDIC lawyers clearly communicated the litigation risk of going forward with the Notice. Fully apprised of the pros and cons, supervision and legal division officials ultimately determined to move forward with the enforcement proceeding, which is consistent with guidance offered by the OIG.[32] The Notice was filed on

[30] Materials referenced in the Draft Report indicate that the credit risk examiners initially misunderstood the nature and scope of the assignment; after they received clarification, they produced the review on the topic requested.

[31] *See People v. JTH Tax, Inc.*,, 212 Cal. App.4th 1219 (Cal. Ct. App. 2013); *United States v. HS Financial, LLC*, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013), *aff'd in part on other grounds, rev'd in part on other grounds*, 592 F. App'x 387, 391 (6th Cir. 2014).

[32] The practices followed here are consistent with the guidance offered in the OIG's Report from 2014 titled "Enforcement Actions and Professional Liability Claims Against Institution-Affiliated Parties and Individuals Associated with Failed Institutions:"

> We understand that it is important to ensure that individual cases are sufficiently strong to avoid setting precedents and jeopardizing future cases. However, legal officials need to ensure that their risk appetite aligns with that of the agency head. Ultimately, legal officials should clearly communicate the legal risks of pursuing a particular EA, but the agency head or senior official with delegated authority should set the level of litigation risk that the agency is willing to assume.

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February 9, 2011 with the concurrence of the then-General Counsel and the DGC himself. Clearly, the then-General Counsel and the DGC by their own actions demonstrated their belief that the Notice was legally supportable.

On May 3, 2011, the FDIC issued an Amended Notice of Charges that sought a CMP based on a variety of violations identified in the horizontal review conducted on February 15 and 16, 2011. The Amended Notice included a CMP assessment based on compliance and safety and soundness violations, including obstructing an FDIC examination. After the Amended Notice was issued, lawyers in the Chicago Regional Office addressed in a memorandum to the then-General Counsel concerns that they had about the compliance charges in the Amended Notice. The Draft Report suggests that these concerns were never addressed. In fact, enforcement lawyers (and subject matter experts) of the Legal Division reviewed and addressed point-by-point – in a series of memoranda – the concerns raised by the attorneys in [redacted][33] Meanwhile, attorneys in both headquarters and [redacted] continued to move toward trial as they engaged in active discovery in the enforcement litigation.[34] Throughout the fall of 2011 and until the case settled in December, the FDIC lawyers – attorneys from both [redacted] and [redacted] – continued to operate as a team, meeting regularly to discuss strategy (and the attendant strengths and weaknesses of the case) as they prepared for what everyone believed would be a contentious trial.

The TILA claim figured prominently in the case because [redacted] made approximately 800,000 RAL loans in 2010 alone and failed to disclose its tax refund administration fee (TRAF) as part of its APR on any loan. Because the average TRAF fee was thirty dollars, [redacted] was facing potential disgorgement of at least $24 million on the TILA claims alone. In October, [redacted] moved for summary disposition on the TILA claims. It is notable, in light of the litigation risk concerns expressed by some in the Legal Division about the safety and soundness claim predicated on the loss of the DI, that [redacted] did not seek summary disposition on the DI claim or any other claim besides the TILA claim.

While the FDIC was preparing its opposition to the motion for summary disposition, the parties entered into settlement negotiations. The DCP Director led the negotiations for the FDIC while the bank's CEO led the negotiations for [redacted] By this point, the relationship between [redacted] and the FDIC had become strained. As a result, the [redacted] [redacted] – who was relatively new to the FDIC and had, up to that point, limited involvement with [redacted] was in a better position to conduct meaningful settlement negotiations. Contrary to the suggestion in the Draft Report that lawyers were not involved, however, Legal Division lawyers advised the DCP Director throughout the negotiations. Attorneys provided input and analysis, drafted the settlement agreement, and engaged in numerous back and forth interactions with the DCP

See 2014 OIG Report at 24.

[33] The memoranda were dated October 3, October, 7 and October 17, 2011 (refuting point by point concerns raised by the [redacted] [redacted] regarding [redacted] alleged violations of TILA, ECOA, UDAP, and GLBA, as well as audit deficiencies and inadequate underwriting)..

[34] Each side had produced approximately 90,000 pages of documents at the time of settlement.

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Director over strategy and terms. At the time, Legal Division staff was also heavily involved in discovery, responding to motions and preparing a case for trial. The Legal Division team was also drafting a Second Amended Notice based on findings during discovery that the bank had interfered with an earlier, pre-announced visitation.

The Second Amended Notice was not filed because the parties reached a settlement in early December. The settlement, the terms of which were embodied in a Consent Order and CMP Assessment issued on December 8, 2011, included [redacted]'s agreement to exit the RAL program at the end of the tax season and to pay a CMP in the amount of $900,000 to resolve all the violations.

Communications Between FDIC Board Members and Staff Were Appropriate

The Draft Report suggests that discussions between staff and FDIC Board members on the RAL programs were unusual and inappropriate. However, as discussed below, such discussions are expected and appropriate. No member of the FDIC Board directed FDIC staff to order any banks to discontinue offering RAL products or to take any action that was not supported by supervisory findings.

The FDIC bylaws set forth the organizational structure of the FDIC and the foundation for communications and exercise of authority of both the FDIC Board of Directors (Board) and its Officers. The FDIC Board has overall responsibility for managing the FDIC, while day-to-day responsibility for managing the FDIC and supervising its Officers and other senior staff is delegated to the FDIC Chairman. The bylaws provide the division directors and General Counsel with broad authorities to supervise the programs under their direction. The Board additionally grants specific delegations of authority for applications, notices, enforcement actions and other matters.

The Board reserves to itself, notwithstanding any other delegations of authority, consideration of matters "which would establish or change existing Corporation policy, could attract unusual attention or publicity, or would involve an issue of first impression. The Board expects each Division and Office Director, through his or her immediate supervisor (if any), to be responsible and accountable for ensuring that any such matters are brought to the attention of the FDIC Chairman to determine whether such matters should be considered by the Board. This reservation of authority is referred to within FDIC as the "major matters resolution."

Consistent with this broad delegation of the Board's vested management authority, officers of the Corporation have a duty to keep the FDIC Chairman informed of their actions, as well as other Board members as appropriate. The Directors of RMS and DCP meet this duty through regular briefings of the Chairman and updates to other Board members about the ongoing activities in their organizations. In addition, they provide written reports to the FDIC Board of actions taken under their delegated authority, such as actions on applications, notices, enforcement matters and the conduct of special insurance examinations (also known as backup examinations). Similarly, consistent with their joint responsibility for overall management of the

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FDIC, the FDIC Chairman and other Board members clearly have the authority and responsibility to discuss the affairs of the FDIC and the actions being undertaken by its officers and senior staff.

The Role of the Case Review Committee

The Bylaws of the FDIC also provide for the establishment of standing or special committees to perform such duties and exercise such powers as may be directed or delegated by the Board from time to time. The Case Review Committee (CRC) is a Standing Committee of the FDIC Board that is responsible for overseeing enforcement matters. The CRC is composed of five voting members, one of whom is an internal FDIC Board member who also serves as Chairman of the CRC. The other four CRC members consist of one special assistant or deputy to each of the other four FDIC Board members. The General Counsel serves on the CRC as a non-voting member.[35]

On November 5, 2010, FDIC staff provided CRC members with a Recommendation to Pursue a Consent Order and civil money penalty (CMP) against [redacted].[36] The proposed Consent Order addressed significant risk management concerns regarding the bank's ability to operate its RAL program in a safe and sound manner without the (formerly available) IRS DI, as well as ongoing compliance management issues from its inability to effectively monitor its over 10,000 third-party relationships with tax preparation offices. That case would be considered at the November 15, 2010 CRC meeting. As is standard practice, the submission included the proposed Consent Order itself. Prior to the CRC meeting, staff provided in-person briefings to the CRC members that requested briefings—as is common practice.

Also in advance of the CRC briefing, the FDIC Chairman's designated CRC member advised the FDIC Chairman of concerns about the wording of two provisions in the proposed Consent Order. The FDIC Chairman discussed these concerns with the CRC Chairman, resulting in modifications to the Consent Order, which was then presented to the CRC. The CRC Chairman, on behalf of the FDIC Board, was (and is) responsible for overseeing the enforcement process and, to a large extent, serves as a *de facto* gatekeeper as to the initiation of proceedings or the resolution of proposed matters. In that role, the CRC Chairman met regularly with senior DSC and Legal Division enforcement personnel to review enforcement activities and matters. While the Board members' deputies or special assistants served on the CRC, it was equally appropriate – and not unusual -- for the CRC Chairman to advise and consult with the FDIC

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[35] Prior to 2004, the CRC was comprised of seven members, one of whom was an FDIC Division Director. Resolution No. 74120 reduced CRC voting membership from seven to five individuals, placed one of the FDIC's internal Board members on the CRC as its Chairperson, delegated additional authority to staff and the Chairperson, and removed the Division Director voting member in order to the ensure that the CRC, a Standing Committee of the Board, was independent from staff. Since that time, CRC voting membership has been comprised solely of the Corporation's Board members or their representatives.

[36] The CMP was proposed based on findings of violations of Treasury Department regulations governing the use of the ACH payments system for processing government benefit payments through [redacted]. [redacted] had allowed third-party vendors to transfer up to 4,300 bank accounts for Social Security recipients without the customers' knowledge or consent.

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Chairman or other Board members on matters brought to the CRC, particularly those involving overall supervisory approach or those that may be unusual. Along the same lines, it was wholly permissible and appropriate for the FDIC chairman and the CRC chairman to engage with staff in active debate over a matter affecting the Corporation.[37]

On November 15, 2010, staff received a unanimous non-objection from the CRC to pursue a Consent Order and Civil Money Penalty (CMP) against [redacted] Because staff was seeking a CMP against [redacted] the case was presented to the full CRC.

[redacted] declined to stipulate to the Consent Order or the CMP and staff moved toward consideration of filing a Notice of Charges (Notice). On February 9, 2011, the FDIC filed its first Notice of Charges against [redacted] for unsafe or unsound underwriting practices with respect to its RAL program.[38] The Notice alleged that [redacted] failure to consider a customer's ability to repay did not mitigate the absence of the DI and failed to consider data needed to assess risk in an unsecured consumer loan portfolio. Accordingly, the Notice sought an Order to cease and desist under section 8(b) of the FDI Act. Because it was a stand-alone cease and desist proceeding and did not involve a CMP, the applicable FDIC Board delegations vested authority to issue the Notice of Charges with the DSC Division Director or her delegate, with the concurrence of the Legal Division. Consistent with the delegations, the DSC Deputy Regional Director, with the concurrence of the then-General Counsel and the Deputy General Counsel (despite concerns he raised in handwritten notes cited by the Draft Report), approved the Notice.

Because DSC determined that the case against [redacted] was a significant matter, staff consulted with the CRC Chairman prior to filing the Notice. After consultation, the CRC Chairman advised staff that he did not object to the proposed Notice and took care to advise the other CRC members of staff's intent to file a Notice. Staff advised board members and their deputies that they were available for a briefing, but none was requested.

In April 2011, after receiving the Report of Visitation from the Horizontal Review, staff went before the CRC to request authority to issue an Amended Notice of Charges (Amended Notice) under section 8(b) and a $2 million CMP under section 8(i). The CRC, by a unanimous vote, expressed no objection. The Amended Notice was filed on May 3, 2011.

Settlement Negotiations were Handled Properly

The settlement negotiations that occurred between two separate FDIC officials and [redacted] management were consistent with FDIC policy. The Draft Report expresses concern that [redacted] was allowed to qualify for the "failed bank bid list" soon after its agreement to exit

[37] The Board is charged with managing the Corporation. *See* 12 U.S.C. § 1812(a)(1) ("The management of the Corporation shall be vested in a Board of Directors ....").
[38] The Notice did not seek a CMP on the Treasury Regulation violations at this time because that was considered a compliance issue and staff wanted to see the results of the upcoming horizontal review. The Treasury Regulation violation claim was one of the claims in the Amended Notice of Charges filed in May of 2011.

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the RALs business. Banks routinely take actions to remedy regulatory deficiencies in order to qualify for new or expanded business activities that require regulatory permission. For example, a bank that is prevented from opening a new branch or acquiring another institution because of an unsatisfactory CRA record will take steps to improve its CRA record in order to engage in expansionary activities.

[redacted] took steps to improve its oversight of EROs and documented those steps in an ERO Oversight Plan that was presented to the [redacted] RD for review and approval. The requirement for the ERO Oversight Plan was also documented in the Stipulation to the December 8, 2011, Consent Order signed by [redacted] board of directors. Examiners reviewed the ERO oversight plan during the September 26, 2011, risk-management examination and the concurrent September 12, 2011, compliance examination. [redacted] management had implemented a number of measures to enhance RAL underwriting, broaden audit oversight and training initiatives at the EROs, and to help ensure that consumers understood their refund options, as well as the nature of a RAL transaction. These enhanced measures were ready for implementation for the 2012 tax season, which would be the final season that [redacted] offered RALs.

The risk-management examination was mailed to [redacted] on December 7, 2011, and upgraded the management rating from 3 to 2 and the composite rating from 3 to 2. The compliance examination was mailed to [redacted] on December 9, 2011, and upgraded the compliance examination from 4 to 2 and the CRA rating from "Needs to Improve" to "Satisfactory." [redacted] now met the qualifications to be added to the "failed bank bid list" and it was added.

Not allowing [redacted] to qualify for the "failed bank bid list" after exiting the RALs business and thereby eliminating the primary source of supervisory concerns could have been seen as retaliatory.

Actions to be Taken in Response to the Draft Report

The FDIC believes that the supervision and enforcement activities that occurred with respect to the three banks discussed in the Draft Report were supported by the supervisory record and handled in accordance with FDIC policy. Nonetheless, the Draft Report did identify areas where better communication, both internally and externally, could have improved understanding of the agency's supervisory expectations and bases for action. Additionally, the Draft Report describes at least one instance in which a former employee – new to the FDIC at the time – communicated with external parties in an overly aggressive manner. The FDIC does not condone such conduct, that type of conduct is not consistent with FDIC policy, and steps were taken to address the conduct at the time.

We look forward to reviewing the details of the final report and will provide actions to be taken in response within the 60-day timeframe specified by the OIG.

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Conclusion

The FDIC's mission is to promote public confidence in the financial system. The dedicated staff of the FDIC carries out this mission on a daily basis, by examining banks to ensure that institutions are offering safe and sound products in compliance with consumer protection laws and by taking corrective action when they are not. The FDIC's Board is responsible for the overall management of the FDIC, with the day-to-day management, and additional broad authority delegated to the officers of the FDIC to carry out the FDIC's mission. Communication between officers and Board members and between Board members is necessary and appropriate for the Board members to ensure they are meeting their obligations. The supervisory and enforcement activities described in the Draft Report were appropriate, legally supported, and carried out consistently with the expectations laid out in the FDIC's Bylaws.

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Appendix A – Expanded Supervisory History for [redacted] and [redacted]

Supervision History of [redacted]

Risk management reports of examination for 2004 through 2006 contained limited discussion of the RAL program, and the 2006 compliance examination indicated that practices that led to the ECOA violations in 2004 had been corrected. The 2007 risk management report of examination contained a number of comments. The examiner observed that RALs volume had reportedly increased [redacted] percent in 2007. Notwithstanding this increase in volume, net profit was [redacted] percent lower than at the same period in 2006 because of the unusually high loss rate. The examiner additionally noted that the securitization of RALs had mitigated liquidity risk during the peak funding season and helped to assure that the capital position would not be compromised. The examiner described the bank as heavily dependent on noncore liabilities, including brokered deposits.

To ensure close coordination between the risk and compliance disciplines in the supervision of consumer products offered through third parties, the [redacted] was preceded by a joint review of the RALs program by risk management, consumer compliance and information technology examiners. The May 16, 2008 joint review memorandum identified numerous weaknesses in program administration and oversight and consumer protection. The number of EROs had nearly doubled since the prior examination, increasing from 4,408 in 2007 to 8,205 in 2008 as bank management had initiated a contract with Jackson Hewitt in September 2007 and had added a number of independent tax preparers after a large commercial bank active in the RAL business reduced its exposure to those EROs. The examiners conducted views at ten locations. The examiners also expressed concern that lending practices may be predatory, as data suggested that the bank had targeted the loans in predominantly minority census tracts. The findings of the joint review were to be rolled into the May 2008 compliance and risk management reports of examination.

The compliance examination contained a comprehensive discussion of the JET findings. Board and management oversight of the program was described as weak, with a demonstrated inability to effectively supervise, on a proactive basis, the breadth of RAL activities. The examiners cited significant violations of ECOA, TILA, Privacy of Consumer Financial Information and Electronic Signatures in Global and National Commerce. The examination resulted in a compliance rating of 4 and a Community Reinvestment Act (CRA) rating of "Needs to Improve," and the compliance examiner recommended corrective action in the form of a Cease and Desist Order. The bank's board of directors stipulated to the Cease and Desist Order (C&D) on February 20, 2009. The C&D was dated February 27, 2009 and became effective March 9, 2009.

The 2008 risk management examination concluded four months earlier than the compliance examination, so it only included preliminary compliance examination findings. Examiner review of the RAL program identified inadequate controls over third party tax

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preparers, resulting in apparent violations of consumer protection regulations, noncompliance with the *Interagency Guidelines Establishing Information Security Standards* for failure of EROs to secure confidential customer information, and an apparent violation of [redacted] State Law for failure to maintain RAL applications. The examiner further noted that a security breach on the bank's website resulted in the exposure of confidential customer information. Relative to the management of third-party risk, the examiner pointed out that ERO agreements were weak as they did not include standards required for the safeguarding of customer information and prior external audits had identified weaknesses in safeguarding customer loan files. However, management had not taken action to enhance requirements or re-evaluate EROs with identified lax safeguards. The examiner made a number of recommendations to improve ERO contracts, expand ERO audits, develop procedures for follow-up on ERO noncompliance, clarify the loan application/agreement, enhance training, and document how bank documents would be retrieved from an ERO with which the bank determined to no longer do business. Three pages of the report were dedicated to documenting management's commitments regarding necessary program improvements for 2009. The risk management examiner assigned a Management component and composite rating of 2.

The 2008 risk management report of examination was transmitted to the Bank's board of directors on August 8, 2008. On August 15, 2008, the Bank's holding company, possibly seeking to avoid further FDIC supervision of its RAL business, filed an application with the Office of Thrift Supervision to merge the Bank into its affiliate [redacted], [redacted], which was regulated by the Office of Thrift Supervision (OTS).

On August 26, 2008, DSC notified the bank in writing that, during the ongoing 2008 compliance examination, examiners had identified Regulation B violations, which demonstrated overt discrimination and a pattern or practice of discouraging or denying applicants for RALs in violation of ECOA. The letter also offered bank management the opportunity to provide any clarifying or additional information prior to the required referral to the Department of Justice (DOJ). Management disagreed with the examination findings, stating that it did not believe that the FDIC had "a basis for making a DOJ referral, taking any enforcement action or seeking any remedial measures." Management also demonstrated a lack of understanding of its responsibilities and obligations in the third-party relationship through its assertion that, "[c]ontrary to the assertion in your letter, an ERO does not act "on behalf of the Bank," even though the EROs were acting as *de facto* loan officers and extending millions of dollars of credit on behalf of the bank.

In March 2009, the bank's holding company withdrew its application with OTS, to merge the Bank into its affiliate [redacted].

Just before the start date of the 2009 risk management examination, FDIC and OTS discovered that [redacted] had moved the RAL business to its sister thrift for the 2009 tax season. Neither FDIC nor OTS were aware of this action until offsite monitoring programs flagged the sister thrift as having doubled its assets. [redacted] was still retaining the credit risk by simultaneously purchasing the loans and providing other services. This could have had the effect

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of making the RAL origination activity not subject to FDIC supervision or the requirements of the Cease and Desist Order, even though [redacted] was exposed to the risk of the RAL business. OTS ordered the thrift to cease the business, and the RAL program was returned to the bank in preparation for the 2010 tax season. Subsequently, in September 2009, FDIC directed [redacted] in writing, to provide prior notice of any material business plan changes.

The July 2009 risk management examination included a comprehensive evaluation and discussion of the RAL program. The examiner noted continued weaknesses in ERO training, as reflected by the bank's mystery shopper results and concluded additional efforts were necessary to improve product delivery, disclosure, and ultimately customer product understanding. The examiner also identified liquidity and capital pressures during the tax season as the bank relied on brokered deposits to hold RALs on balance sheet as securitization activities proved cost prohibitive; and recurring problems in program administration related to ECOA compliance and information security of customer data. The examiner observed that while management took action to correct these problems in a timely manner, similar problems were criticized during the 2008 RAL program review. The examiner opined that both issues demonstrated the complexity of managing third party risk associated with this program and noted that the issues would be addressed in the 2009 FDIC Compliance Examination. The examiner concluded that management had not acted in accordance with consumer compliance regulations nor fully corrected deficiencies in the Tax Refund Solutions business segment, which were also identified at the prior safety and soundness examination, primarily in the management of third party risk. He advised that management's abilities were measured not only by financial performance, but also by its ability to operate within governing regulations and to properly oversee all business line risks. The examiner lowered the Management component rating to 3 and maintained the composite rating of 2.

The October 2009 compliance examination resulted in a continuation of the compliance rating of 4 and CRA rating of "Needs to Improve." Although the examiner noted some improvement in the Bank's compliance management system since the May 27, 2008 examination, the examiner observed that management had been largely reactive to supervisory findings and had not exerted sufficient oversight (particularly with respect to its high-risk, non-traditional product lines) to achieve a satisfactory compliance posture. Violations of ECOA were cited and referred to the DOJ, and the examiner noted that the institution had established a history of substantive violations of ECOA over the last several examinations, although the violations at this examination were in the commercial loan portfolio. The examiner described board and senior management oversight of third-party risk as "still lacking" and cited several events that had occurred since the prior examination that raised concerns with the ability of the board and senior management to oversee the bank's third party risks. Included were two instances of significant changes being made to the RAL program without comprehensive and formal deliberation at the board level, as required by the outstanding C&D.[39]

[39] Section 2(a) of the C&D dated February 27, 2009, required the board of directors to increase its participation in the affairs of the bank in order to assume responsibility for the supervision of all of its consumer compliance activities, including the bank's Tax Refund Solutions program.

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The examination included the results of on-site interviews with EROs that noted apparent improvements in ERO training compared to the findings of the 2009 risk management examination and mystery shopper results. However, the examiner-in-charge reported that the examiners conducting the reviews believed the EROs had been coached to provide the right answer, and suggested surprise visits during the next tax season in 2011.

The October 2009 compliance examination was lengthy, taking a little over a year to complete. Complications included the fact that [redacted] had moved the business to its sister thrift for the first quarter 2009 tax season. Additionally, without providing the advanced notice required by written direction from the FDIC, [redacted] executed contracts to expand the business with [redacted] and another tax preparation business, [redacted], with which [redacted] initially contracted that fall. This action took place within nine days of OCC directing [redacted], which funded nearly half of [redacted] originations and [redacted] percent of Liberty's originations, to exit the RAL business, and just three days before the start of the 2010 tax season.

In its letter to [redacted], OCC noted that there were significant legal, compliance, vendor management and reputation risks inherent in the bank's RAL business activities. Consequently, OCC considered any RAL activity that placed additional strain on the capital and operations of the bank unsafe or unsound. [redacted] had acquired this business when FBD declined to offer [redacted] paystub loans in 2006. In 2007, [redacted] had to charge off $62.7 million in RAL losses due largely to high incidences of tax fraud that ran primarily through a series of [redacted] franchises.[40]

[redacted] notified FDIC of its assumption of this business after-the-fact on December 29, 2009. Given the bank's record of risk management and compliance problems and the fact that the bank was still operating under a C&D, FDIC directed the bank, in writing, to submit a plan within 15 days to exit the RALs business within 60 days. A second letter was issued the next day to instead require that a meeting be scheduled within 60 days to discuss the future viability of the program. These events were clearly laid out in the 2009 compliance report of examination.

On March 10, 2010, while the compliance examination was ongoing, the [redacted] advised the bank's Board by letter that preliminary examination findings had identified significant ongoing concerns regarding the bank's ability to appropriately assess, measure, monitor and control third-party risk. More specifically, the [redacted] stated that the concern centered on the bank's continued expansion of third-party relationships relative to its non-traditional business lines while operating under an outstanding C&D, which expressly requires controlling such third-party risk. The [redacted] observed that although material weaknesses had been identified internally by the bank's audit programs, the Board and management made a business decision to continue to expand the RAL program. Continued growth, during a period when the bank was operating under a C&D and ongoing

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[40] Katie Kuehner-Hebert, *In Brief:* [redacted] *Cites Tax Loan Problems*, American Banker, Apr. 25, 2007 (53% increase in charge-offs).April 25, 2007.

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audits were identifying material weaknesses was imprudent and reflected unfavorably on management and the Board. Because of the weaknesses, the [redacted] proposed a Consent Order limiting expansion of the RAL program and requiring the bank to cease making RALs through any ERO added by the December 27, 2009 and December 29, 2009 amendments to the bank's ERO contracts.

Supervision Relative to [redacted]

As with FBD and [redacted], the 2004 compliance examination of [redacted] cited violations of the ECOA. The examiner also noted that the RAL program was not audited. The examiner recommended that management better direct the limited resources of the audit department to other high-risk areas. A compliance rating of 2 was assigned.

The 2004 and 2005 FDIC risk management examinations included limited discussion of the RAL program. The 2004 report observed that a reserve for loan losses was established at the beginning of each year for $35 per loan and the 2005 report cited a contravention of the *Interagency Policy Statement on External Auditing Programs of Banks and Savings Associations* for the board's failure to review external audits and ensure audit coverage of Dollar$$$Direct (a direct deposit product with elements of payday lending) and the bank's tax division. The payday lending program was also described as not being in compliance with the FDIC's *Guidelines for Payday Lending*. At the 2004 examination, the Management composite was rated 2 and the composite was rated 1; following the 2005 examination, those respective ratings were 3 and 2.

A compliance visitation was conducted concurrently with the 2005 risk examination to focus on the RAL program and Dollar$$$ Direct. The visitation document states, "...a targeted review of the bank's Tax Refund Anticipation Loan (RAL) program was conducted to determine the bank's uniform lending practices under this program. This review was undertaken as a national review of RAL lenders and their corresponding program is being conducted and has resulted in the identification of a uniform lending practice of obligating all the owners of the tax refund on the note, a practice which violates Regulation B, which implements the Equal Credit Opportunity Act (ECOA)." The violation was referred to the Department of Justice in accordance with the FDIC's statutory obligations under 15 U.S.C. 1691. Several other violations were noted in the Dollar$$$ Direct program.

The July 2006 compliance examination cited repeat violations of ECOA for using nonspecific reasons for denial and several others related to other business lines of the bank. The examiner concluded the bank's Compliance Management System was weak, downgraded the bank's compliance rating to 3, and requested that the bank enter into a Memorandum of Understanding. The examiner also explained the remedial action necessary to correct the ECOA violation identified at the 2005 visitation. Bank management was provided a sample advertisement of rights letter to be mailed to affected consumers. Management responded by expressing concern that some RAL consumers may sue the bank.

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The FDIC was not alone in its assessment of [redacted]s RAL program. The January 2007 State of [redacted] risk management examination downgraded the Management component and composite to 3, because of significant deterioration in asset quality and significant weaknesses in board oversight. The examiners noted that the bank continued to lack audit coverage for the RAL program for the second examination in a row. Further, examiners found that the bank's asset liability management model was unable to adjust earnings to reflect the actual impact of RALs. The examiner noted that the net interest margin had been partially impacted by a significant reduction in the volume of RALs due to increased competition. The state and the FDIC entered into a Memorandum of Understanding (MOU) with the institution to address the identified weaknesses. Two provisions of the MOU related to the RAL program. One provision required the bank to implement and enforce an effective system of internal and external audit and internal controls consistent with the comments in the report of examination. The other relevant provision required the bank to correct all violations of law and contraventions of policy. The MOU became effective on April 9, 2007.

Despite these issues, the February 2008 joint risk management examination maintained the [redacted] Management component rating and upgraded the composite rating to [redacted] For the third examination in a row, examiners cited repeat contraventions of policy regarding the lack of audit coverage for the RAL program. For the second examination in a row, examiners noted improper consideration of RAL income in the asset liability management model. Examiners further noted that an internal audit had not been conducted since 2005, and concluded that an annual audit of the RAL program was necessary, as the activity was complex and high risk. Examiners also noted that due diligence procedures regarding the acceptance of EROs into the program needed to be expanded to include a criminal background check. The bank was listed as a defendant in a lawsuit filed by a Texas bank for non-payment of 35 official checks issued by [redacted] to RAL customers as loan proceeds. The examiner noted that the RAL program continued to serve as a major source of both interest and non-interest income, despite a [redacted] percent decrease in net income from the program between 2006 and 2007 due to competition and declining product demand. The examiner recommended that management enhance granularity within the budget by providing additional detail on major earnings factors, such as the RAL program. The bank was not in compliance with the two MOU provisions related to the RAL program, one requiring an effective system of internal and external audit, and another requiring correction of all contraventions of policy. The examiner recommended external audit coverage of the RAL program. Management refused to make such a commitment.

A separate memo from the 2008 FDIC examiner-in-charge to the [redacted] dated April 14, 2008 contained additional details about the RAL program. Based on a RAL program income statement that had been provided by the bank, the examiner determined that RAL losses (charge-offs) were 48.9 percent of RAL related income up to that point in 2008 and [redacted] percent 2007, respectively. The examiner additionally reviewed losses as a percentage of gross revenue, describing that ratio as the best indicator of the impact of charge offs on earnings and noting that the calculation for 2007 was [redacted] percent. High losses in 2007 related to a fraud in Florida involving a long-term ERO partner of the bank. Similar activity by an ERO in [redacted] was identified in 2008. The examiner concluded, "[t]he internal control structure is

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minimal, at best, and there is an over-reliance on the honesty of the ERO. As such, the RAL program appears especially susceptible to fraud. … The program is higher risk than more traditional consumer lending and does increase the risk profile of the bank."

The March 2009 joint risk management examination observed that the prior examination noted serious deficiencies in the RAL audit program and ERO due diligence process. The bank had retained a consulting firm to review the completeness of RAL documents and determine whether required disclosures had been provided, but had not yet conducted an independent audit of the program. This resulted in the citation of a contravention of policy for the fourth examination in a row. Examiners stated, "Management should incorporate an annual independent review of this function as part of its risk mitigation process due to the heightened legal, reputational, and operational risk of this product." In response, the board agreed to conduct annual third-party audits. The bank was a defendant in two lawsuits stemming from its RAL program.

The asset liability management model issued had been resolved, but the bank was still not in compliance with two provisions of the MOU, one requiring an effective system of internal and external audit, and another requiring correction of all contraventions of policy. Nonetheless, the examiners upgraded the Management component to 2 and continued the composite rating of 2. They also requested that the Board adopt a Resolution to commit to implement and enforce an effective system of internal and external audit and internal controls and implement an annual review of the RAL program by a qualified third party, beginning at the conclusion of the 2008 tax season. The engagement letter for the third-party review was to be forwarded to the Regional Director and the Commissioner.

The May 2009 compliance examination was lengthy, taking more than eighteen months to complete. A letter to the bank's board dated November 1, 2010 advised the board of preliminary findings. The letter stated, "[t]o date, our findings have identified numerous material weaknesses, particularly as it relates to the institution's ability to measure, monitor, and control third party risks associated with the products offered through the bank's Tax Division (including, but not limited to the Refund Anticipation Loan (RAL) program) and the [redacted] program…" The board was criticized for failing to exercise appropriate oversight of the institutions nontraditional products at a level commensurate with the heightened compliance, legal and reputation risks associated with the bank's third-party relationships through which the products were offered. Additionally, the bank had failed to establish effective monitoring and auditing reviews to assess the elevated risks associated with the nontraditional products. The bank had also failed to provide the necessary resources and expertise to manage and oversee the significant risks posed by the nontraditional products and the bank's reliance on third-party vendors. The letter advised the bank's board that a Consent Order would be sought. Finally, the letter advised the board that the concerns relative to the oversight of third party risk would be considered in determining component and composite ratings for the ongoing risk management examination and requested the bank's plan for underwriting RALs absent the Debt Indicator.

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The May 2009 report of examination was transmitted to the bank on December 30, 2010. In addition to the findings shared with the bank's board in November, the report of examination outlined that the bank had not fully complied with the MOU. The examiner noted that deficiencies identified in both internal and external audits during 2008 had not been addressed. Finally, the third-party monitoring program did not meet the guidelines of the FDIC's *Guidance on Managing Third-Party Risk*. The examiner assigned a compliance rating of [redacted] and a CRA rating of Needs to Improve. With respect to the downgrade of the compliance rating, the examiner stated, "[t]his deterioration is primarily attributed to the Board and senior management's failure to properly oversee its high-risk banking activities." The bank was offering RALs through 487 EROs, and examiners visited eleven. The examiner wrote in the confidential section of the report, "[i]n order to ensure that the bank is not inappropriately preparing its vendors for onsite examination visits, bank representatives should not be notified well in advance of the time when vendors will be visited."

Supervision Relative to [redacted]

[redacted] entered into the RAL business in 2007. During 2007, the State of [redacted] conducted a risk management examination and the FDIC conducted a compliance examination, and in January 2009, FDIC conducted a risk management examination. None of these examinations appeared to cover the RAL program. The February 2010 State of [redacted] risk management examination described the operations of the RAL program. In addition to the bank offering RALs through a third party (First Knox Financial – a tax preparation company), the bank's affiliate Loan Central Inc., provided tax preparation for local customers and offered RALs. State examiner comments noted that year-end liquidity ratios were overstated as the bank had raised brokered deposits to fund RALs during the income tax season. The operations and management's oversight of the RAL program were first examined for compliance by the FDIC on September 13, 2010 and for risk management by the FDIC on February 22, 2011. The compliance examination cited deficiencies in board and senior management oversight and program management and assigned a rating of [redacted]. The risk management examination noted the bank would no longer participate in the RAL program after this year. The bank was rated a [redacted] for other asset quality deficiencies.

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***Appendix B – Expanded Discussion of Rating Downgrades for* [redacted] *and* [redacted]**

As noted earlier, in the section, *FDIC's Supervisory Process*, the FDIC's Division of Risk Management Supervision takes many steps to ensure that its on-site examination activity is carried out on a consistent basis and that the findings of examinations are presented in a manner that is consist with FDIC rules and regulations, policy and procedures. Among those steps is a review of each report of examination by a trained case manager. The FDIC's processes anticipate that findings or report commentary may need to be changed from time to time. For this reason, the FDIC *Risk Management Manual of Examination Policies* states, "[g]enerally, the examiner-in-charge (EIC) should discuss the recommended component and composite ratings with senior management and, when appropriate, the board of directors, near the conclusion of the examination. Examiners should clearly explain that their ratings are tentative[41] and subject to the review and final approval by the regional director or designee."

When changes are made to ratings and substantive changes are made to report commentary, those changes are to be fully communicated to the examiner-in-charge. To the extent the examiner-in-charge disagrees with the changes, processes exist to document those disagreements. In 2010, when changes were made to the ratings at [redacted] and [redacted]y, examiner disagreements were not properly documented. Nonetheless, the changes were appropriate, supported by the examination record, and consistent with the UFIRS.

[redacted] *Downgrade*

The tentative ratings assigned by the examiner at the August 30, 2010 risk management examination of [redacted] were [redacted]. During the regional office review process, the rating was downgraded to [redacted]. The final Management, Earnings and Liquidity component and the composite ratings assigned at the August 30, 2010 risk management examination of [redacted] were accurate, were supported by the examination record, and were consistent with the definitions in UFIRS. The key elements of the UFIRS definitions supporting the final ratings assigned versus the original examiner ratings are shown below.

Management Component Rating of [redacted] versus [redacted]

The UFIRS defines the Management component ratings of [redacted] and [redacted] as follows:

"A Management rating of [redacted] *indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled."*

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[41] See FDIC *Risk Management Manual of Examination Policies, Basic Examination Concepts and Guidelines* section, page 1.1-3.

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"A rating of [redacted] indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled."

Management's abilities are measured not only by financial performance, but also by its ability to operate within governing regulations, its responsiveness to recommendations from auditors and supervisory authorities, and to properly oversee all business line risks. The final report of examination properly concluded that management and board performance needed to improve their oversight of the bank's high-risk third-party activities. Accordingly, management and board performance were more accurately characterized as needing improvement than satisfactory, supporting a Management component rating of [redacted].

- The findings of the October 2009 Compliance examination, including the March 10, 2010 FDIC letter sharing preliminary examination findings, were properly considered in the Management component rating and support the assignment of the [redacted] Management component rating.
- The Summary comment on page 1 of the Examination Conclusions and Comments in the final report states, "The continued presence of a deficient consumer compliance program is a serious regulatory concern. The Board also needs to develop a comprehensive strategy to minimize the risks associated with the bank's Tax Refund Solutions (TRS) program. Board and management oversight of these facets of bank operations must be improved."
- The needed board and management oversight improvements were identified in the October 2009 compliance report of examination and through a March 10, 2010 FDIC letter to the bank's board of directors sharing that preliminary examination findings had identified significant ongoing concerns regarding the bank's ability to appropriately assess, measure, monitor and control third-party risk. Findings included that the board and management had not exerted sufficient oversight to achieve a satisfactory compliance posture as evidenced by repeated ECOA violations, noting that the violations occurred in the commercial loan portfolio at the current examination and in the RAL portfolio at two of the three prior examinations and that continued growth, during a period when the bank was operating under a C&D and ongoing audits were identifying material weaknesses was deemed imprudent and reflected unfavorably on bank management. The compliance examiner also identified concerns regarding management's compliance with provision 2(a) of the C&D requiring increased participation by the board of directors in the affairs of the bank, including the lack of documented board approval of the transfer of the RAL business to the thrift and the expansion of the Jackson Hewitt and Liberty contracts as well as poor oversight of the Currency Connection program and fair lending risks.
- Bank management's contention that the bank had not expanded its RAL business by expanding the number of EROs through which it made loans was inaccurate. The bank did not originate loans through any EROs in 2009 because it had transferred the origination business to its sister thrift. Therefore, the comparison of the number of EROs

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in 2008 and the number post the amendments of the bank's contracts with [redacted] and [redacted] was accurate.

- The August 30, 2010 risk management examination report identified two risks to the bank's TRS program that needed to be considered by bank management as part of a comprehensive strategy to minimize the risks associated with the TRS program. A comprehensive strategy was important because it accounted for [redacted] percent of the bank's first half net income, as was noted in the commentary under the Earnings component. The first risk was that the IRS would not be providing the Debt Indicator to RAL originators in the 2011 tax season, increasing credit risk in this type of lending. Further, the IRS had also announced it would develop the capability to net tax preparation fees from a refund and remit the proceeds to the appropriate party, which was the equivalent of the electronic refund check and electronic refund deposit programs offered by the bank; the potential impact on the bank's tax division could be significant and the board was cautioned to assess the impact on earnings, capital accretion and loan quality.

Earnings Component Rating of [redacted] versus [redacted]

The UFIRS defines the Earnings component ratings of [redacted] and [redacted] as follows:

"A rating of [redacted] indicates earnings that are strong. Earnings are more than sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings."

"A rating of [redacted] indicates earnings that are satisfactory. Earnings are sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings. Earnings that are relatively static, or even experiencing a slight decline, may receive a 2 rating provided the institution's level of earnings is adequate in view of the assessment factors listed above."

Earnings strength is measured not only by the quantity and trend of earnings but also by factors affecting the sustainability or quality of those earnings. The income stream derived from the bank's Tax Refunds Solution (TRS) program, which was significant, was expected to be impacted by events that were beyond Management's control. Due to reliance on the TRS income, any depletion would affect the Bank's operations. In view of these facts, the stability and quality of earnings are more accurately characterized as satisfactory rather than strong, supporting an Earnings component rating of [redacted].

- The examination report noted the IRS would not be providing the Debt Indicator to RAL originators in the 2011 tax season, increasing credit risk in this type of lending. Management indicated it was trying to develop a model that would serve as a substitute for the Debt Indicator, but expected the absence of the Debt Indicator would result in smaller loans and less loan volume.

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- Further, the examination report noted that the IRS had also announced it would develop the capability to net tax preparation fees from a refund and remit the proceeds to the appropriate party, which was the equivalent of the electronic refund check and electronic refund deposit programs offered by the bank; the potential impact on the bank's tax division was unknown at the time, but could be significant.

<u>Liquidity Component Rating of [redacted] versus [redacted]</u>

The UFIRS defines the Liquidity component ratings of [redacted] and [redacted] as follows:

"A rating of [redacted] indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs."

"A rating of [redacted] indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices"

In evaluating the adequacy of a financial institution's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile.
Funds management practices should ensure that liquidity is not maintained through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions. In view of the institution's reliance on brokered funding, which may not be available in a time of financial stress or adverse changes in market conditions, the liquidity position is more accurately described as satisfactory than as strong, supporting the [redacted] rating assigned.

- The report of examination described reliance on noncore funding as elevated as evidenced by the net noncore dependency ratio of [redacted] percent as of June 30, 2010. Comments indicated that management used brokered deposits to fund the RAL program during the 2009 and 2010 tax seasons, as such the volume of brokered deposits increases dramatically at the end of the year.
- Management gathered $921 million in brokered certificates of deposit at the end of 2009, with a weighted average life of three months, and $542 million in brokered certificates of deposit at the end of 2010, with a weighted average life of 55 days.
- Management was terminating a $61 million brokered deposit relationship with Merrill Lynch, stating the funds were more costly than other sources.

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Composite Rating of 3 versus 2

The UFIRS defines the Composite ratings of [redacted] and [redacted] as follows:

"Financial institutions in this group [[redacted]*] are fundamentally sound. For a financial institution to receive this rating, generally no component rating should be more severe than* [redacted]*. Only moderate weaknesses are present and are well within the board of directors' and management's capabilities and willingness to correct. These financial institutions are stable and are capable of withstanding business fluctuations. These financial institutions are in substantial compliance with laws and regulations. Overall risk management practices are satisfactory relative to the institution's size, complexity, and risk profile. There are no material supervisory concerns and, as a result, the supervisory response is informal and limited."*

"Financial institutions in this group [[redacted]*] exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than* [redacted] *Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a* [redacted] *or* [redacted] *Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions."*

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. In light of the noncompliance with a key provision in the outstanding C&D related to board participation in the activities of the bank, the bank was determined to need more than normal supervision, in the form of an amended C&D, supporting the [redacted] rating assigned.

- [redacted] exhibited a degree of supervisory concern in the Management component area as evidenced by the [redacted] Management component rating continued from the prior examination.

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- [redacted] had not complied with provision 2(a) of the C&D requiring increased participation by the board of directors in the affairs of the bank, including the lack of documented board approval of the transfer of the RAL business to the thrift and the expansion of the [redacted]t and [redacted] contracts as well as poor oversight of the Currency Connection program and fair lending risks.
- A new C&D was issued to the bank in March 2010 to limit the bank's expansion of the RAL program and to cause it to cease originating loans through the newly added EROs.

[redacted] *Downgrade*

The tentative ratings assigned by the examiner-in-charge of the October 25, 2010 risk management examination of [redacted] were [redacted]. During the regional office review process, the case manager downgraded the rating to [redacted]. The examiner-in-charge agreed with these changes. The final rating assigned was [redacted] The Management component and the composite ratings assigned at the October 25, 2010 risk management examination of [redacted] were accurate, were supported by the examination record, and were consistent with the definitions in UFIRS. The key elements of the UFIRS definitions supporting the final ratings assigned versus the changed (and agreed upon) examiner ratings are shown below.

<u>Management Component Rating of [redacted] versus [redacted]</u>

The UFIRS defines the Management component ratings of [redacted] and [redacted] as follows:

"A rating of [redacted] indicates management and board performance that need improvement or risk management practices that are less than satisfactory given the nature of the institution's activities. The capabilities of management or the board of directors may be insufficient for the type, size, or condition of the institution. Problems and significant risks may be inadequately identified, measured, monitored, or controlled."

"A rating of [redacted] indicates deficient management and board performance or risk management practices that are inadequate considering the nature of an institution's activities. The level of problems and risk exposure is excessive. Problems and significant risks are inadequately identified, measured, monitored, or controlled and require immediate action by the board and management to preserve the soundness of the institution. Replacing or strengthening management or the board may be necessary."

- Management's abilities are measured not only by financial performance, but also by its ability to operate within governing regulations, its responsiveness to recommendations from auditors and supervisory authorities, and to properly oversee all business line risks. The final report of examination properly concluded that management and board performance needed to improve risk oversight as it pertained to non-traditional products. Management oversight of RALs and the [redacted] was described as ineffective, and management's lack of adequate internal controls and audit reviews were cited as a concern, both of which exposed the bank to heighted third-party and

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reputational risks. Capital, asset quality, earnings and liquidity were described as satisfactory, but subject to potential impact from risks associated with the non-traditional banking products. Accordingly, management and board performance and risk management practices were more accurately characterized as deficient than needing improvement, supporting a Management component rating of [redacted]

- The bank's board of directors had adopted a Board Resolution on April 28, 2009 to address continuing concerns cited in the March 23, 2009 risk management report of examination. The bank had been operating under an MOU, but given the compliance with all provisions except the two covering the RAL program, the MOU was terminated in favor of a narrow Board Resolution covering the remaining issues. One provision required annual audit reviews of the RAL program; although management had obtained an annual review of the RAL program, the review was limited in scope, insufficient for the risk profile of the RAL program, and characterized as inadequate. A contravention of the Interagency Policy Statement on the Internal Audit Function and Its Outsourcing was cited during the examination. This was the fifth examination in a row that an audit-related contravention had been cited relative to the RAL program. The examiner-in-charge of the 2008 examination, when the audit policy contravention was cited for the third examination in a row, had described the significance of this concern in the memo documenting the RAL program review: the examiner concluded, "[t]he internal control structure is minimal, at best, and there is an over-reliance on the honesty of the ERO. As such, the RAL program appears especially susceptible to fraud. ... The program is higher risk than more traditional consumer lending and does increase the risk profile of the bank."
- The bank, in fact, had twice been the victim of frauds, once by EROs in [redacted] and another time in [redacted].
- The findings of the May 15, 2009 compliance examination were also properly incorporated into the Management component rating. A Consent Order and Civil Money Penalties were being pursued as a result of the adverse findings at that examination. Compliance had been rated [redacted] and CRA had been rated Needs to Improve. The CRA rating downgrade was primarily due to multiple violations of Section 5 of the Federal Trade Commission Act regarding the prohibition of unfair and deceptive acts or practices. These violations related to the bank's adjustable rate mortgage portfolio. Other violations included TILA, the Real Estate Settlement Procedures Act, the Truth in Savings Act, and the Electronic Funds Transfer Act. The compliance examination described board and senior management oversight as weak, especially concerning the non-traditional products offered by the bank through its Tax Division and the [redacted] program. Tax customer information security procedures regarding ERO retention of customer files was also cited.
- Management needed to develop an effective, bank-wide, third-party risk management program to include the guidance provided in the FDIC's *Guidance on Managing Third-Party Risk*.

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<u>Composite Rating of [redacted] versus [redacted]</u>

The UFIRS defines the Composite ratings of [redacted] and [redacted] as follows:

"Financial institutions in this group [[redacted]] exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than [redacted] Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite [redacted] or [redacted] Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution's size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions. Failure appears unlikely, however, given the overall strength and financial capacity of these institutions."

"Financial institutions in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. Financial institutions in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved."

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The composite rating generally bears a close relationship to the component ratings assigned. However, the composite rating is not derived by computing an arithmetic average of the component ratings. Each component rating is based on a qualitative analysis of the factors comprising that component and its interrelationship with the other components. When assigning a composite rating, some components may be given more weight than others depending on the situation at the institution. In general, assignment of a composite rating may incorporate any factor that bears significantly on the overall condition and soundness of the financial institution. The unsatisfactory board and management oversight of and lack of controls around the most significant business product for the bank, in terms of its net income and potential fraud exposure, were accurately characterized as serious deficiencies, supporting the composite rating of [redacted]

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- The factors cited under the Management component reflect serious management deficiencies.
- The weaknesses in the bank's audit program over its most significant line of business, in terms of its impact on net income, had been criticized and left uncorrected over five examinations, clearly demonstrating that the deficiencies were not being satisfactorily addressed or resolved by the board of directors and management.
- Formal enforcement action was deemed necessary to correct the bank's compliance program deficiencies.
- The lack of controls around the high-risk RAL program made the bank vulnerable to fraud, and the volume of activity in which the bank engaged, made the possibility of failure from a fraud a distinct possibility if the problems and weaknesses were not corrected.
- The examiner noted that although the bank had recently committed to exiting the RAL lending program, not actions had been taken to assess the potential impact of the elimination of the debt indicator on loan underwriting and/or earnings and capital.