

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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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. 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

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.

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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 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

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.

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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

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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). 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?

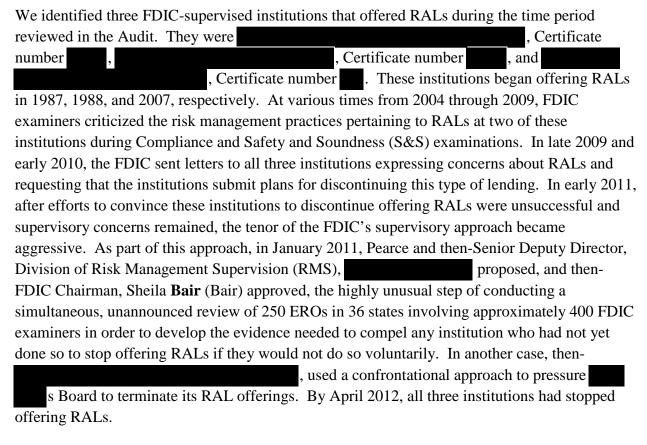
A refund anticipation loan (RAL) is a particular type of loan product, typically brokered by a national or local tax preparation company in conjunction with the filing of a taxpayer's income tax return. As part of the RAL process, the tax preparer, sometimes referred to as an electronic refund originator (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.

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.



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.

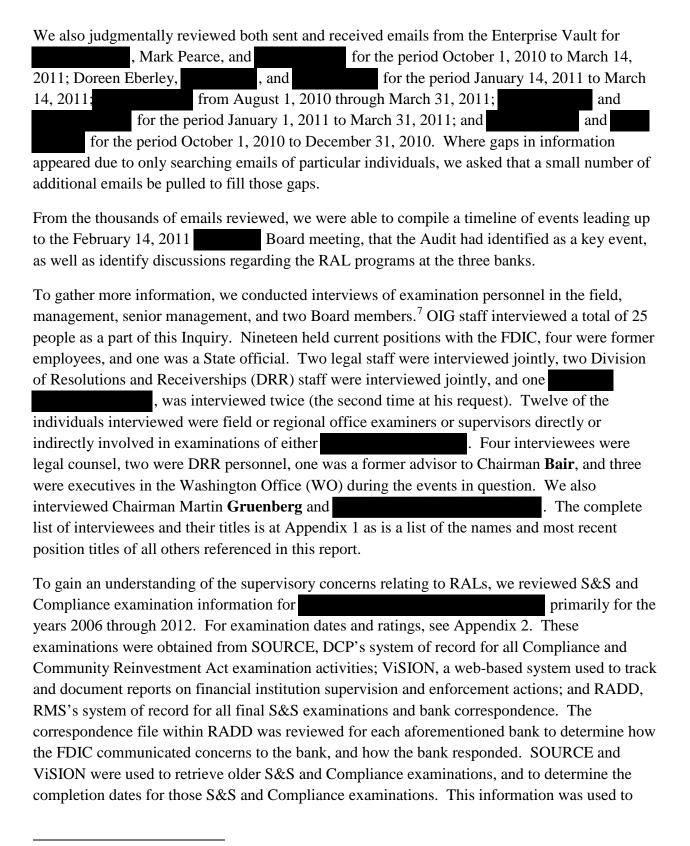
Senior FDIC officials in Washington, D.C., including former Chairman **Bair**, considered the safety and soundness and consumer protection risks associated with RALs to be unacceptable and took actions to prohibit this practice at FDIC-supervised institutions. The FDIC drafted a Financial Institution 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.

In addition to work conducted specifically for this Inquiry, we reviewed the summaries of the

II. Methodology

166 interviews⁶ and other key documents, including emails, developed during the Audit. A iudgmental review of the emails of three FDIC employees, , were also used as a starting point to understand the process followed by staff to complete Compliance and S&S examinations of 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 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 , tax, and, tax refund anticipation loan (TRAL). Based on the information derived from the initial reviews, an Enterprise Vault search was requested for 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 documents and correspondence were: RAL, 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.



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 . 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 .9 This file dealt primarily with and the FDIC's RAL strategy more generally. contained references to 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 RAL program. Among other issues, the consumer groups pointed to 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?" On February 29, 2008, and others that "[t]he , emailed question essentially was why examiners do not criticize 's RAL loan program and I the other day... to let them know the passed it along to and Chairman is asking and will probably ask them directly..." 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. When interviewed as a part of this Inquiry, 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

and

February 25, 2008.

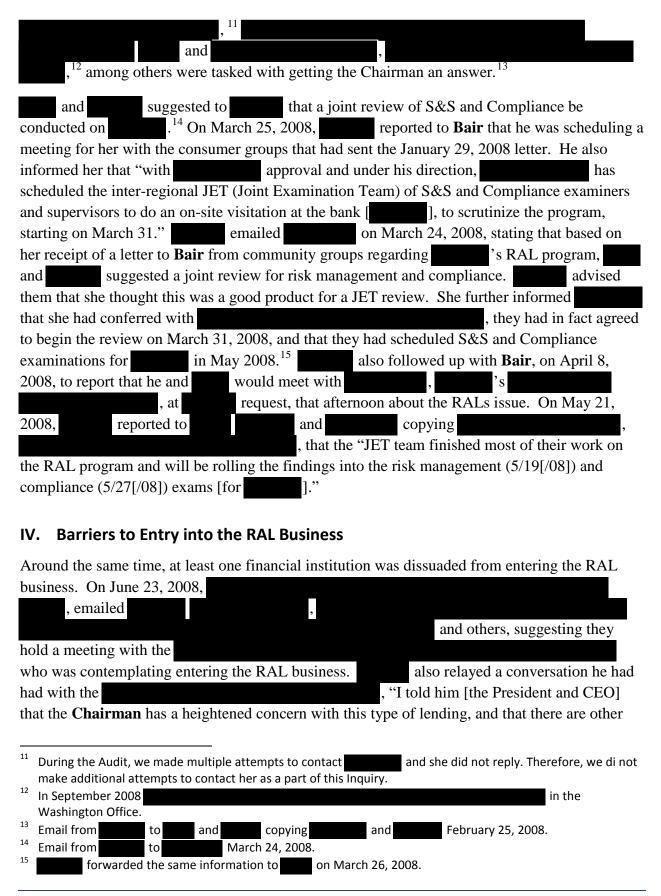
present in the meeting, but may not be inclusive of all who attended a given meeting.

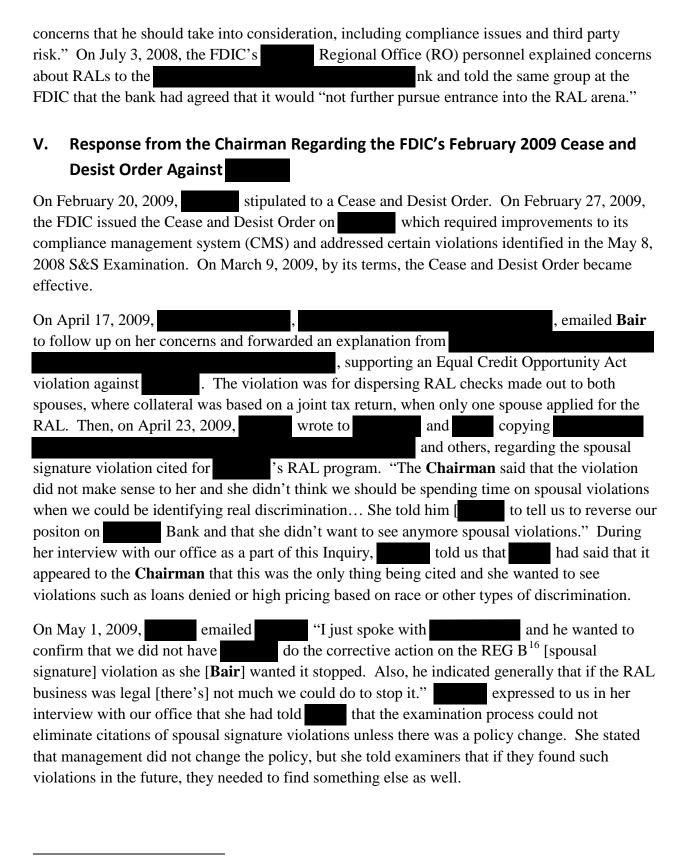
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^{16 12.} C.F.R. Part 202 Equal Credit Opportunity (Regulation B).

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 announced the beginning of the development of a mystery shopper pilot August 5, 2009, program focusing on RAL providers and mortgage originators. , became the point-person. ¹⁸ On August 10, 2009, two FDIC economists, and three lawyers provided (via an email from 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 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 and detailing her undercover attendance at the 2009 Tax Forum in Dallas, Texas, held September 8-10, 2009. She focused on questioning exhibitors, including and , 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.

²⁰ *Id*.

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

¹⁸ *Id*.

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

VII. The Letters to Exit RALs and Their Foundations

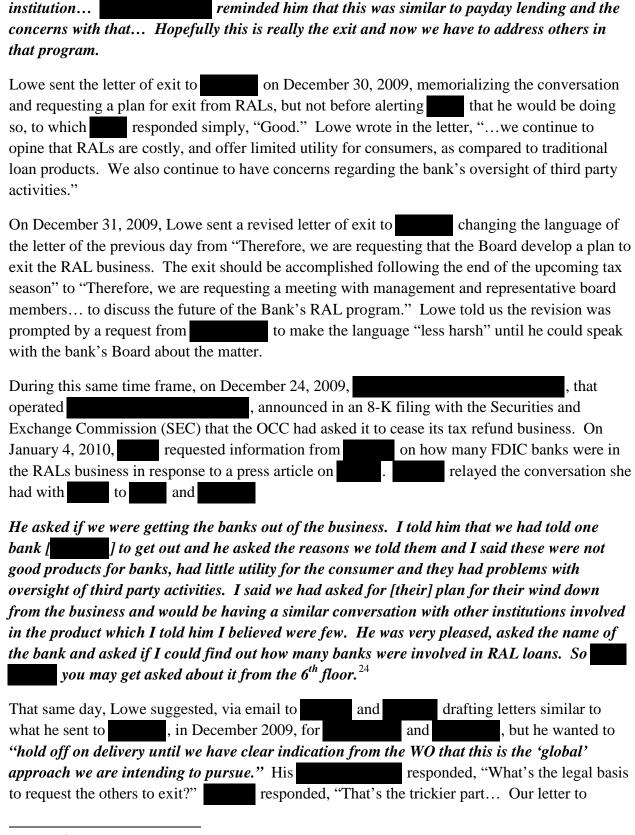
In late 2009, the FDIC contended that 21 had expanded its RAL program while
operating under the 2009 Cease and Desist Order discussed above. In fact, while had
expanded the number of National EROs with whom it was affiliated (from
Liberty Tax Services), it had simultaneously decreased the number of independent 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,
, 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 second '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 ²³ Once at the FDIC, the letter was distributed via email to a wide group including and In response, referenced a meeting that would be held that afternoon with the Chairman on RALs.
In 2009, 's affiliate, , , , , handled RAL origination and purchased the loans on a daily basis. In 2008 and 2010, handled originations directly.
Memorandum from through through to dated April 7, 2010; Undated Memorandum from to 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]."
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...

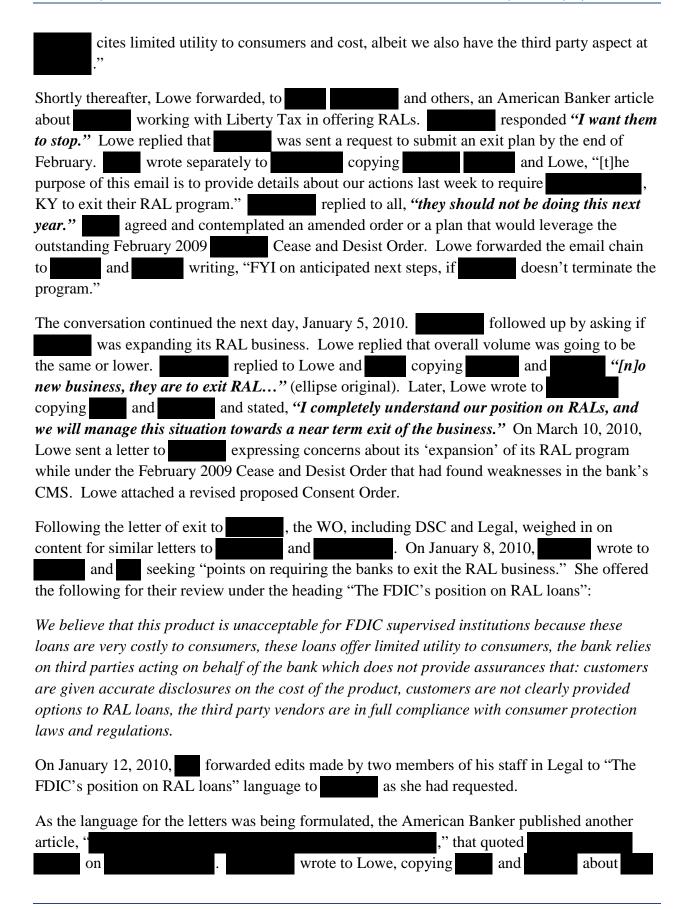
As the current economic crisis continues, more and more institutions are suffering financial difficulties, which can lead them to look for higher returns and fee income wherever possible, including offering products that may not be advantageous for most consumers, or necessarily for the bank. Introduction 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 called him on December 30,
2009, the same day the first letter of exit went to and said he wanted to move quickly
to get a letter to telling the bank to exit its RAL program. Lowe stated that those in the
WO felt that if they could get out of RALs, the other banks would follow. Neither
Lowe nor were at work that day, but Lowe recalled talking, and exchanging emails, with
, and while they composed the letter
that was ultimately sent to that day. The verbiage included text from letters that had
been sent to banks engaged in payday lending, as well as input from regarding what
wanted in the message to .
In one email chain on December 30, 2009, expressed concern about 's potential
expansion of its RAL business to Lowe and "Don't we have problems with
such [that] this would be [in] contravention of our requirements on the company?What I[s]
[sic] going to be your reaction to, and when?" Lowe responded that the 2009 Cease
and Desist Order for "includes several provisions regarding audits and controls of third
party risks, and requirements for 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, emailed 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?" replied later that day "I think we should be
consistent and tell all our banks to get out of the business"
reported, in another December 30, 2009 email to copying Lowe and
that she had spoken with 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."
stated that "[w]e plan to memorialize our conversation with a letter and request a plan to
exit the business within 30 days." forwarded the email to and the same
day.
also emailed and that day stating:
Anthony [Lowe] and spoke with [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



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



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." then forwarded comment, but not Lowe's reply, to "You should read this article. doesn't think he is going to be ordered out of the business. Also it clearly says they will pick up some business from [the OCC regulated bank that had recently exited the RAL business]."
With respect to the OCC order dealing with RALs at emailed copying Lowe, and others on February 3, 2010, that wanted confirmation from the Regional Office that the 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." also reported that, had "looped the Chairman in on this" and other emails in the chain reflect that Gruenberg was aware of the OCC's actions against
Also on February 3, 2010, Lowe sent the letters to and 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, had <i>never</i> 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
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?

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

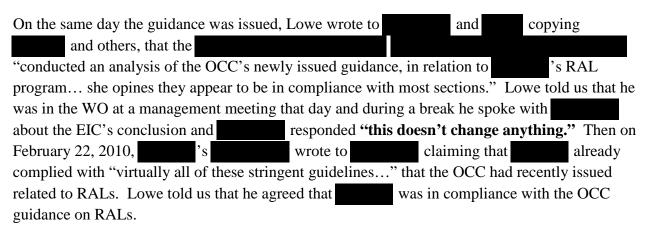
prohibition. The FDIC did not respond to February 9, 2010, letter until eight months later. On wrote to a number of people, including Lowe and responding to had not responded in writing to the letter from a question about why the dated February 9, 2010. He wrote, "The RAL issue is a complex and sensitive 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 and 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 and asking for "full and fair consideration of their request for a meeting prior to agency action in eliminating RALs." Then on February 10, 2010, 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 employee. On March 12, 2010, 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.

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

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

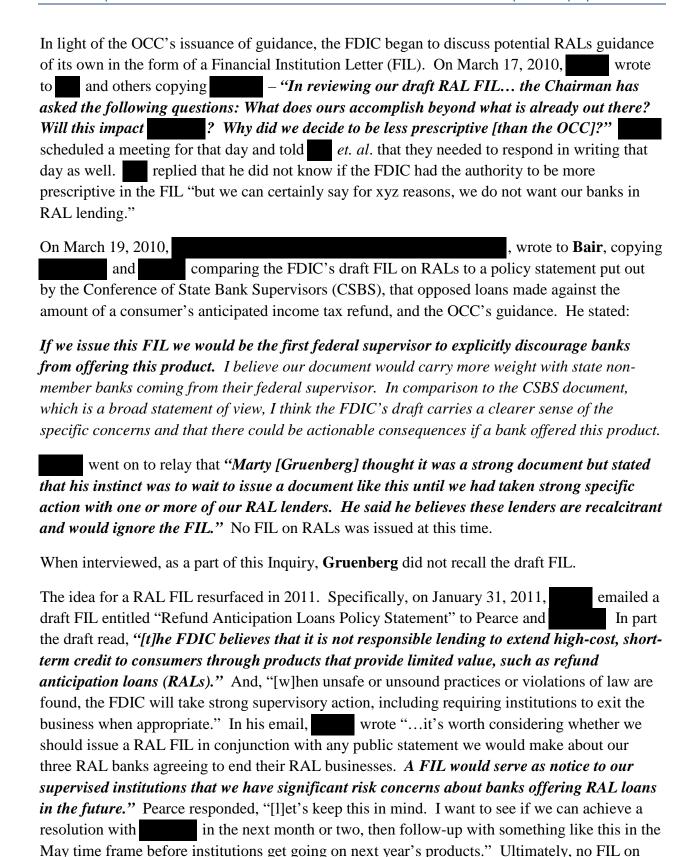
On February 18, 2010, the OCC issued guidance for national banks providing tax refund related products, including RALs. ²⁶ The guidance outlines S&S and consumer protection measures banks should follow. Those measures include:

- 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 refundrelated products.
- ensuring the bank's compliance with all applicable laws and regulations, including those involving consumer protection.



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")

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RALs was ever issued by the FDIC.

X. Response to the OCC's RAL Guidance In response to a telephonic request made of by 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. had requested information regarding the number of EROs with whom was engaged. The bank stated that indicated that "it was the FDIC's desire that the bank not increase the number of EROs in 2011." She suggested 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 not being under an order or engaging in an illegal practice. The CEO stated that ey expected the number of EROs doing business with the bank and the volume of RALs to increase. In the prior year, the proposed lowering the maximum maximum RAL amount was \$7,000; however, 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. commented during our call that the agency is continuing to evaluate if RAL lending is appropriate.

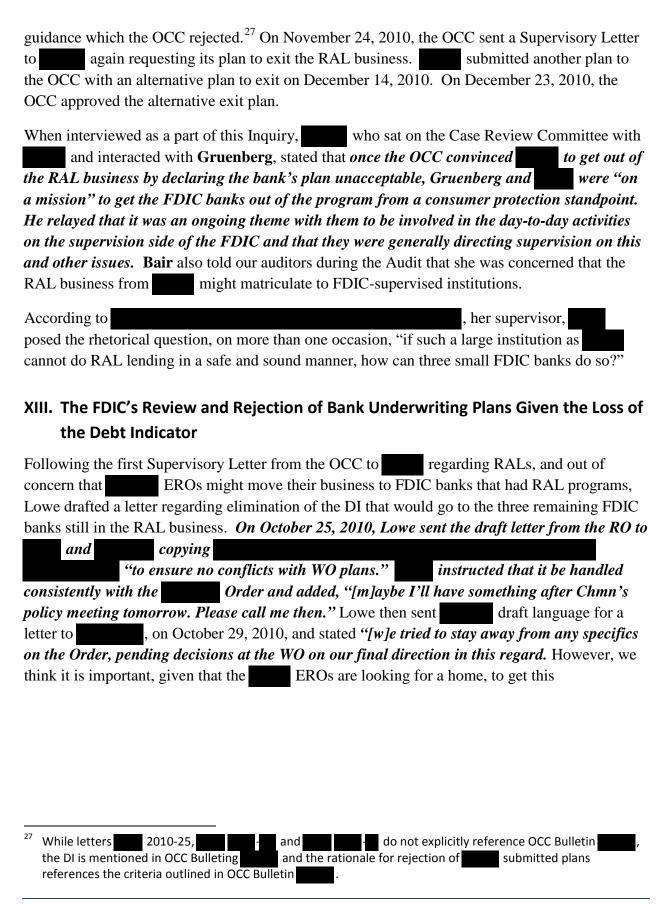
Considering the turn of events since my last letter, it is our desire to continue offering RALs in a safe, sound and responsible manner beyond the 2011 tax season.

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 Exits RALs

Following the issuance of its RAL guidance, the OCC sent a Supervisory Letter, on October 19, 2010, to requesting a plan from the bank to exit its RAL business. submitted a plan to revamp its RAL program in light of the loss of the DI that would adhere to the OCC's



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.

's Underwriting Plan On December 7, 2010,

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

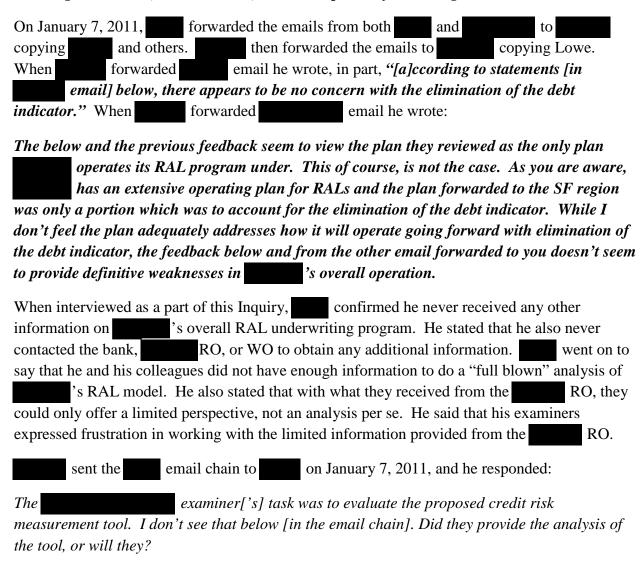
stated, "I haven't ever looked at a program like this so I haven't spent a lot of time previously thinking about the specific risks, but here are some thoughts..." With respect to credit risk he wrote, "[t]here is some general credit risk here although mitigated because the refund will be sent by the 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..."

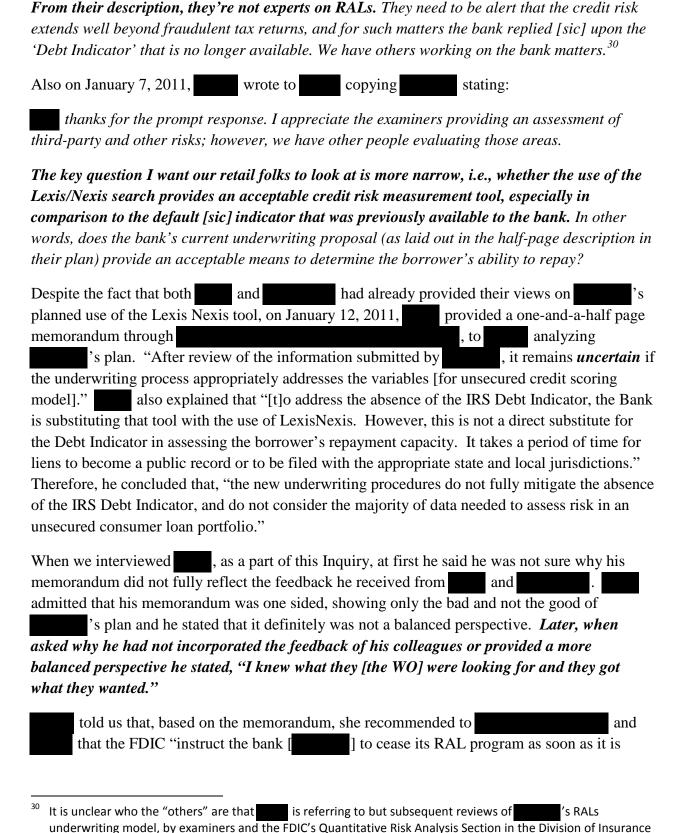
On November 5, 2010, emailed and advising them that the IRS had done away with replied, "[t]hat is true. IRS has stated that when they eliminated it the debt indicator in the past. previously the number of RAL[s] declined tremendously. That is why is [sic] was eliminated this year as a way to put an 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." 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."

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

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,

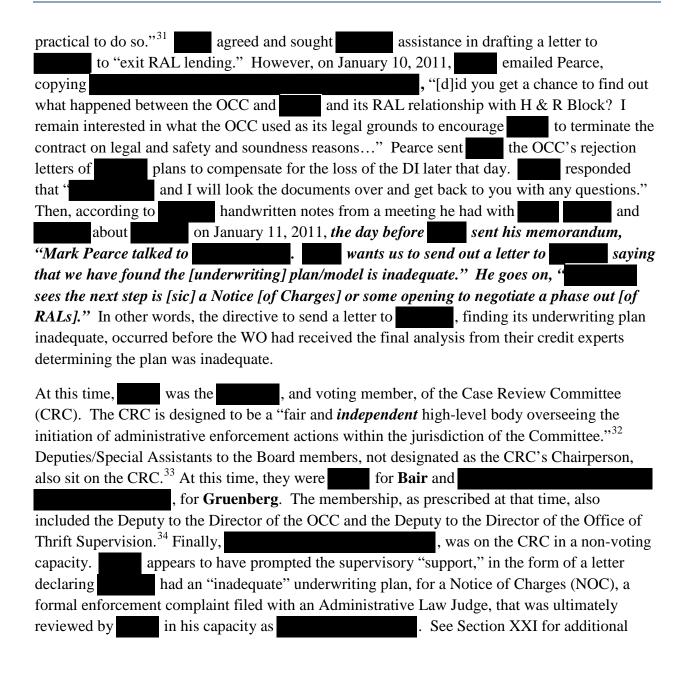
Credit risk is more elevated this year since the IRS did away with lien disclosure to tax preparers. The Lexis Nexis search helps [to] compensate somewhat because that will catch liens on the public record, property liens, and credit bureau information. However, the IRS lien notification was probably 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.





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and Research, reflected that the model adequately addressed the loss of the DI. See Sections XXV and XXX.

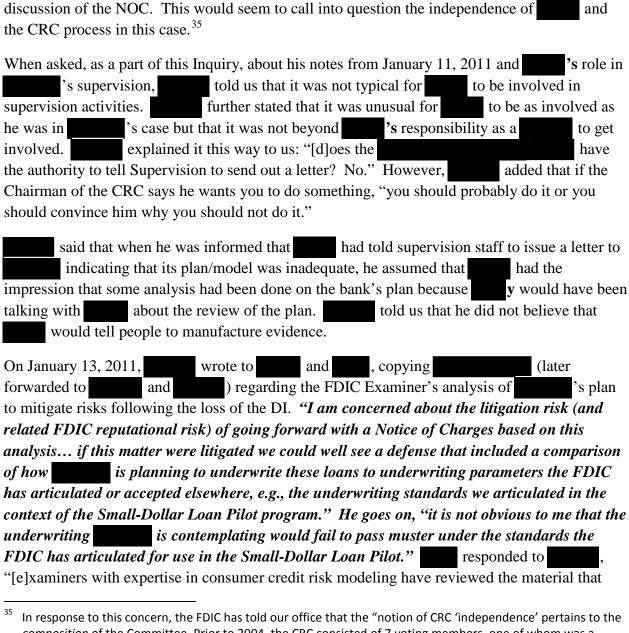


Email from to to copying and and January 12, 2011. Notably, in the email, describes an assessment of 's "model" but, as described elsewhere, only plans, not full underwriting models, were requested and reviewed by the FDIC.

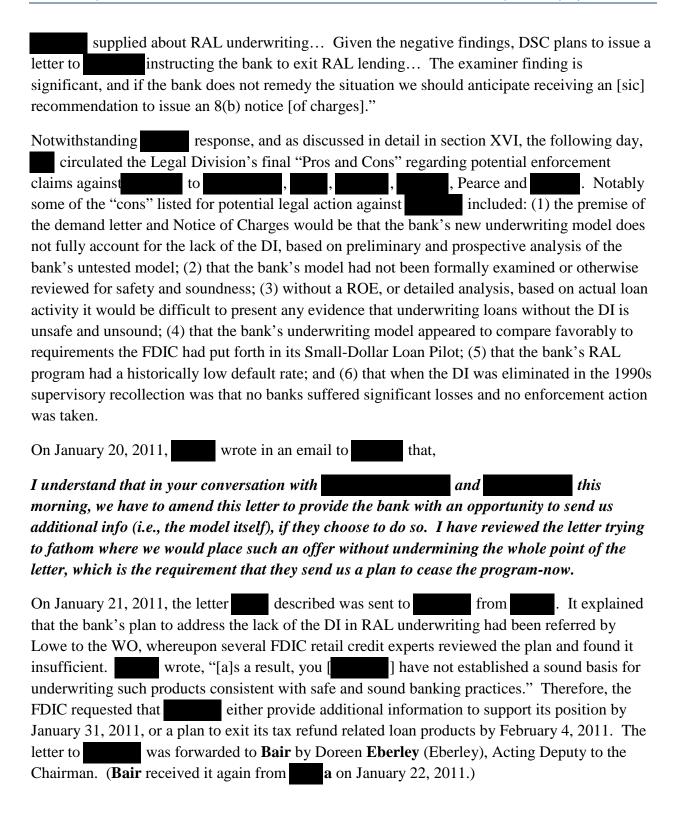
FDIC Board Resolution Seal No. 072277 dated April 6, 2004.

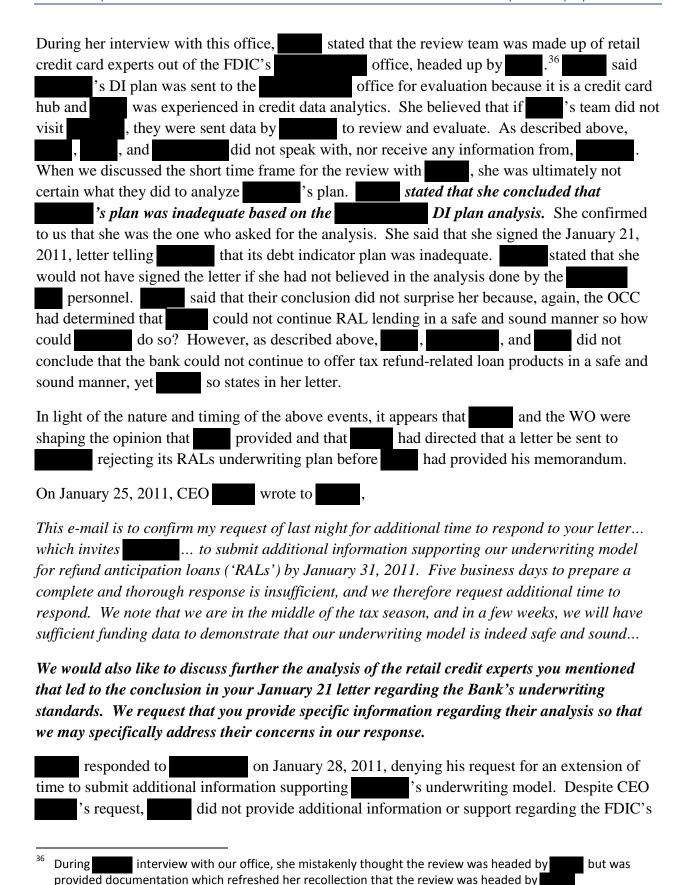
³³ Id.

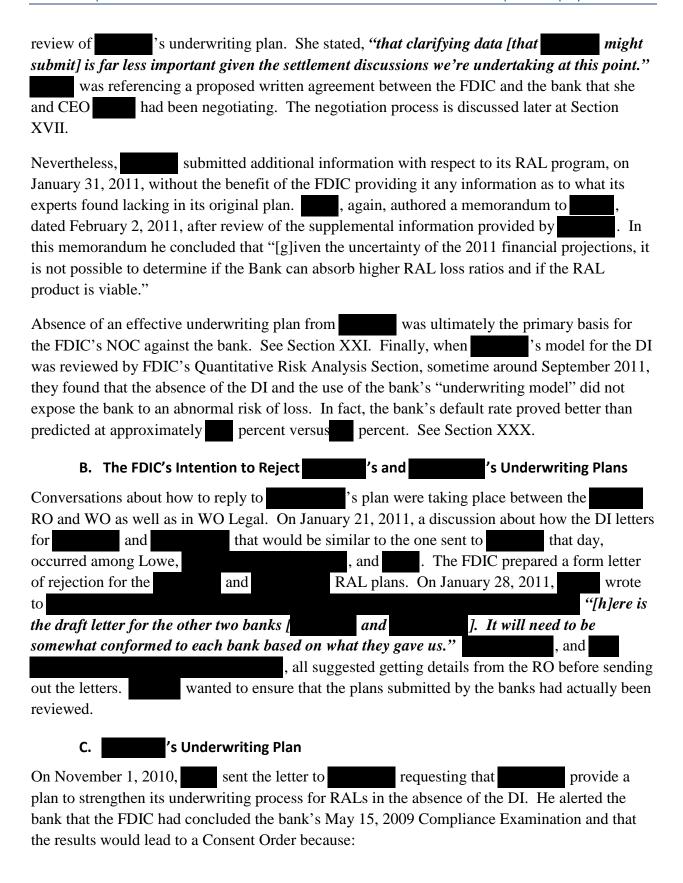
³⁴ Id.



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, was both involved in the supervisory process and he reviewed the case in his capacity on the CRC.







...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, attorney responded to the FDIC's November 1, 2010 letter, the lack of the DL. He stated.

addressing a number of issues, including the loss of the DI. He stated: *Throughout* 20-plus years of offering RALS, the DI periodically has been unavailable for various reasons. During these periods, has effectively minimized the risk of non-payment even without access to the DI. For several reasons, anticipates that, going forward, it will be able to continue to offer RALs in a safe and is currently in the process of finalizing its revisions to the RAL sound manner. underwriting process for the upcoming tax season. However, the bank has already identified several significant changes that will strengthen the RAL underwriting process. 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* 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... 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 letter but, as described later in this report, the FDIC did continue its efforts to get to exit RALs.

D. Underwriting Plan
On November 3, 2010, Lowe sent a letter to strengthen the bank's underwriting of RALs in light of the loss of the DI. On November 17, 2010, the 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 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."
also cited a past product that the bank underwrote, prior to receiving the DI information, that had a charge-off rate of less than 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 percent, on its 2010 RALs. The bank felt it could further decrease its loss rate to a range of percent by implementing risk mitigating measures including, but not limited to, lowering the maximum loar amount from \$7,000 to \$1,800 and utilizing third-party services. A third party service that 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.

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 a second size. Second size and second size and second size and size are size are size and size are size are size are size and size are size are size are size as a size are size are size are size are size are size are size as a size are s

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

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

reviewed the letter submitted by , 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, analysis highlighted underwriting risk, concentration risk, legal/reputational risk, and regulatory risk. identified the bank's concentration of RALs as a point of concern. He noted RAL loans made up percent of the bank's total loans and percent of its Tier 1 Capital as of September 30, 2010, and that a concentration of nearly percent is not reasonable. While an unsecured loan portfolio of 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. 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

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.

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.

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

proposed in

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 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 analysis whether he considered these criteria.

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 as a part of this Inquiry, he told us that while splan 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 could not offer RALs in a safe

On February 3, 2011, Lowe sent correspondence to 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;

and sound manner. To the contrary, he stated that he believed what

its November 17, 2010 letter appeared to be reasonable.

- *Insufficient monitoring or oversight of training for third party vendors; and,*
- *A limited scope audit review.*

_

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 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 , 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, emailed Lowe copying and asking for "...status of and , 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, wrote to Lowe stating that the bank would discontinue offering RAL products "after the 2011 tax season, which ends April 21, 2011." stated that he hoped this letter would "further evidence" the bank's responsiveness to each and every request made by the FDIC. Following exited the RAL business as promised. this correspondence, XIV. The Chairman Raises Questions about RALs and On August 4, 2010, the day before the IRS announced the end to the DI, there was a " " scheduled by the Chairman's office. Required attendees included Bair, 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 's 2009 Compliance ROE. A copy of his letter was sent to **Bair**. Following the meeting, circulated to and others, copying **Bair**, and

1. "What is our strategy regarding RALs – eliminate RAL or get the cost down?"

Chairman's questions and requests from the meeting. They were as follows:

- 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 see selecter."
Taking number seven above first, emailed Lowe, copying emailed Lowe, copying 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 selected to set the record straight. 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 providing a point-by-point response to CEO selection is 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 and to the transfer of the control of t
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. wrote to "[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
On August 16, 2010, provided Legal's response to the Chairman's items numbered two and four above. It was determined that 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 to FDIC's FIL on Affordable Small-Dollar Loan Products, FIL-50-2007. '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.' s fee was \$30.00. This analysis was forwarded to Bair on September 22, 2010.
On September 3, 2010, sent responses to the Chairman's questions and requests but did not directly answer question one. On September 14, 2010, emailed emailed, and others, copying, that "[w]e have sent all the information the Chairman, and others, copying, that "[w]e have sent all the information the Chairman, and others, copying, that "[w]e have sent all the information the Chairman, and others, copying, that "[w]e have sent all the information the Chairman, and others, copying, the complex of the chairman, and the chairman and the chairman and the chairman, and the chairman, and the chairman and the chair

requested to _____." This response, along with a point-by-point response to CEO 's letter to the Ombudsman, was forwarded to **Bair** by _____ 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 "through "through "through "through "through "through "through "through "through the least regulatory concern and "through 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 and the product that 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

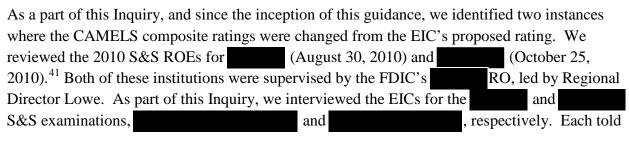
change. The OIG also suggested that DSC consider requiring a record of differences in CAMELS ratings between EICs and management during the course of formalizing its guidance in this area.

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.

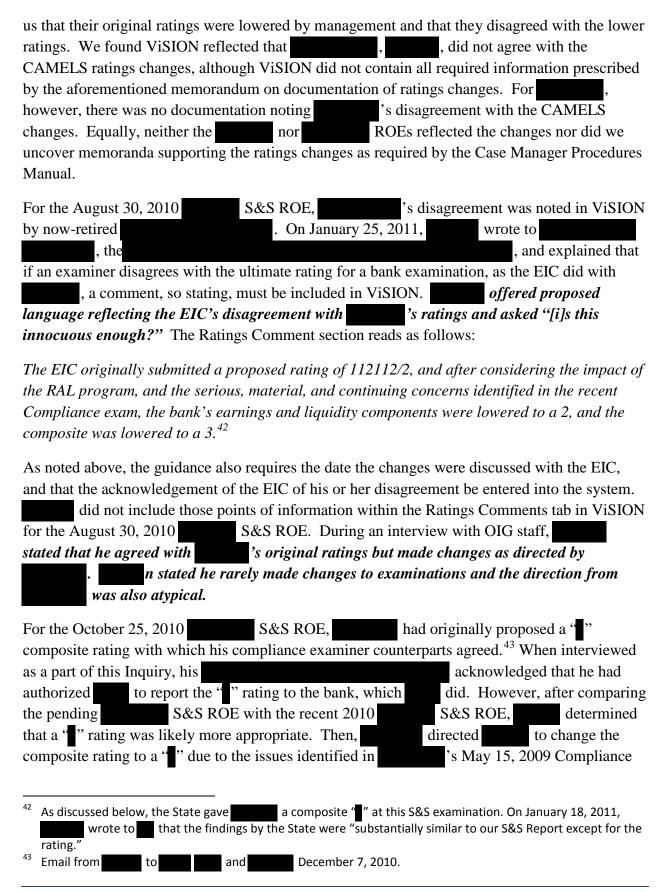
The Regional Director, or designee, is responsible for ensuring the accuracy of the data input into these data fields. The guidance also stated that staff should discontinue the prior practice of documenting rating changes in the ROE and its Confidential Supervisory Section. Upon issuing the new guidance,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

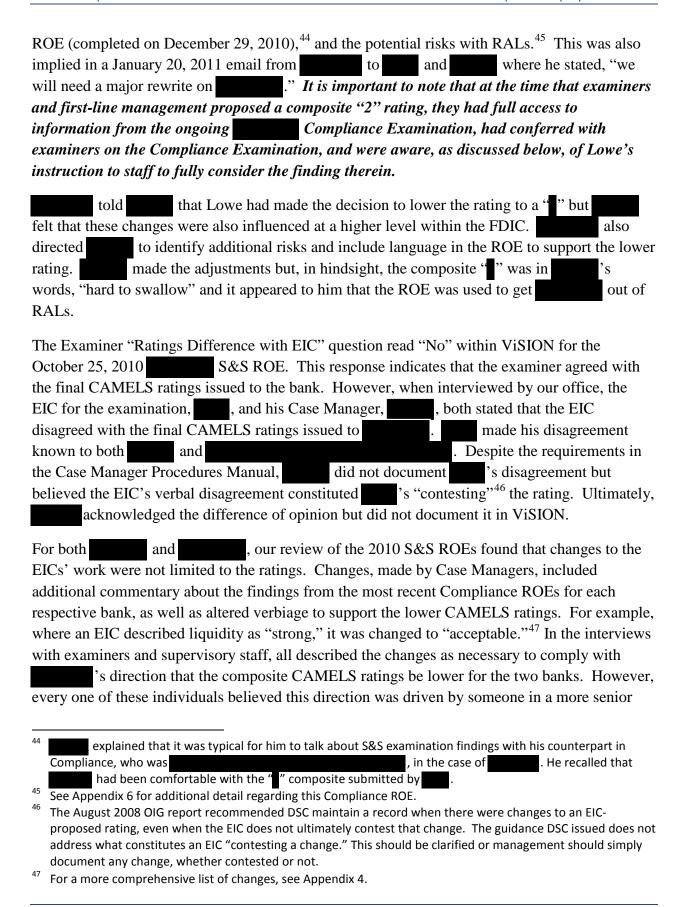
If a CAMELS component or composite rating change is considered, concurrence of the EIC should be sought. If the EIC concurs with the change, the new rating should be reflected throughout the report as well as on the Summary Analysis of Examination Report (SAER). If the EIC does not agree to change the 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.



⁴¹ Dates of ROEs reflect the date the examination began.

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position and potentially in the WO. None of these interviewees knew the identity of the source, and 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 in the August 30, 2010, S&S ROE – Completed October 1, 2010

The August 30, 2010, S&S ROE cited many of the violations previously identified in the bank's October 19, 2009 Compliance ROE. The S&S ROE identified the continued presence of a deficient consumer compliance program as a serious regulatory concern. The S&S ROE noted Serious are subject 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 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 "Tompliance 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. 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 the weaked Lowe if the deserved a "management rating. Lowe said "no," though the bank was on the borderline, he could have made a case for a "management."

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 and and were downgraded based on input from the WO. He stated that he did not recall. When we asked 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 supervisory history related to RALs.

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 '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.
significant increase in earnings from the June 30, 2009, Return on Average Assets (ROAA) of
percent to June 30, 2010, where ROAA was
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 percent for June 30, 2010" which was
above the peer average of percent."
had strong financials, out-performing its peers in many categories. The table below compares to its peer group as of December 31, 2010 (when as a composite rated bank).

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

Source: Uniform Bank Performance Report for

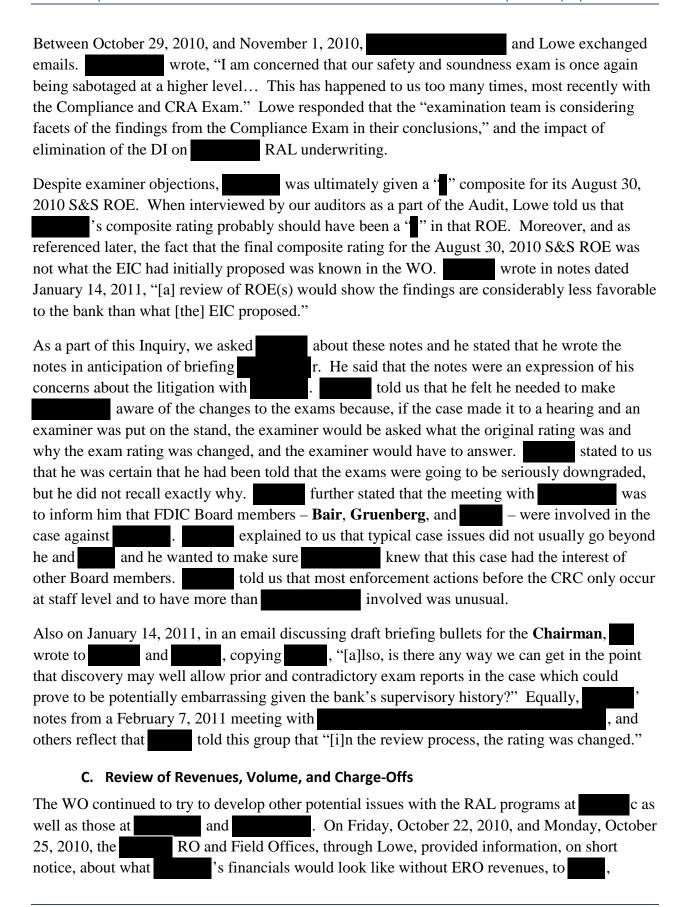
The FDIC and the State of (State) jointly conducted the August 30, 2010 S&S Examination. However, the FDIC and the State issued separate ROEs because they could not agree on an overall composite rating.

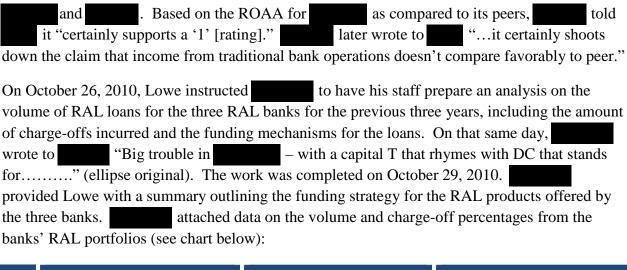
, rated

a composite "]," while the FDIC rated the bank a composite "]."

told us that such divergence in ratings between the FDIC and the State is unusual.

B. Relevant FDIC Internal Communications Regarding the S&S ROE Downgrade
On October 1, 2010, wrote to 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, and others complaining about the recent Compliance Examination. Bair asked what the status was and "[a]re there problems beyond RAL accounts?" confirmed that the issues 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/ Bank Follow-Up Briefing" was scheduled by the Chairman's office. The required attendees included: Bair, , and .
took notes at the October 12, 2010, meeting and listed the attendees as Bair , and . According to and . According to anotes 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?" noted that replied, "yes, IRS is going to get refunds [to taxpayers] in 5 days" (ellipse original) 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 rather than a joint ROE due to disagreements on ratings. Those discussions continued with the WO the next day. Lowe emailed copying and copying and copying and the FDIC's proposed explaining there was a discrepancy between the State of and the FDIC's proposed CAMELS ratings. "In discussions thus far, the state has indicated they are leaning towards a "on the management component, and a" composite. We continue pressing that the
ongoing compliance related issues must be considered, and warrant a on ongoing compliance related issues must be considered, and warrant a one on management, and a composite." responded by questioning a "composite rating. "I've been thinking about this all day today and am worried about the thought process. The CP [Compliance] rating was not right? And we're about to finally issue an order and likely litigated the last 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 "composite rating as follows,"
"[t]he overall composite of ' ' 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 derived from ERO related activities."

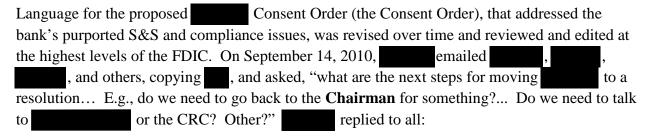




Tax Year	\$ RAL Volume	\$ Gross Charge- Offs	C/O as % of Gross	\$ RAL Volume	\$ Gross Charge- Offs	C/O as % of Gross	\$ RAL Volume	\$ Gross Charge- Offs	C/O as % of Gross
2010									
2009									
2008									
2007									

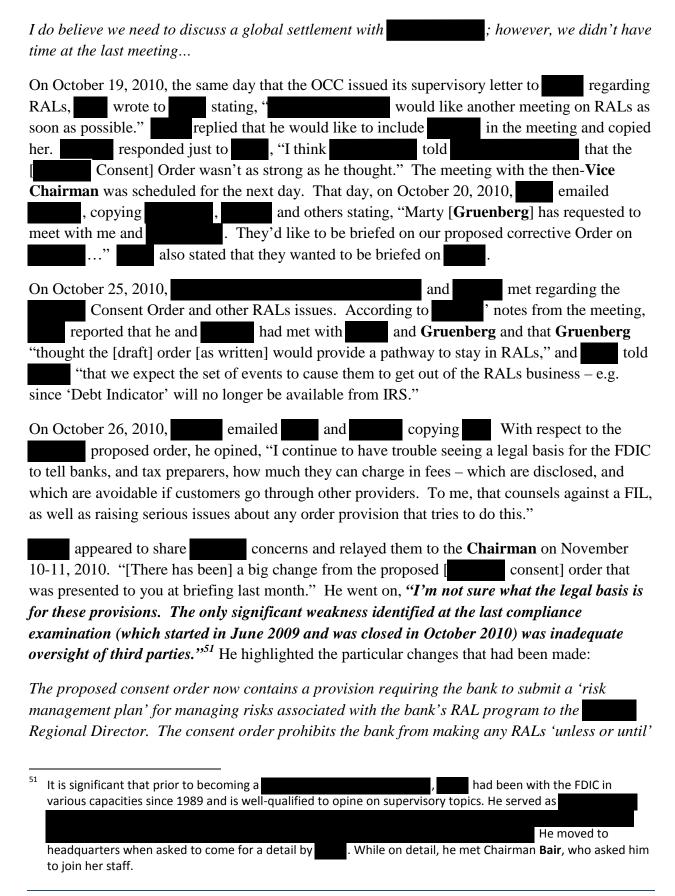
Essentially, all three banks' gross charge-offs as a percentage of loans were very low. Neither nor charged-off over one percent of their RAL portfolio from 2007 through stayed under one-and-a-half percent during the same timeframe.

D. Consent Order Addressing Both Compliance and Safety and Soundness Concerns



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



the risk management plan has been approved by 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?"

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 1½ years. Legal and DSC staff have told me that

and have been pushing for [a] more stringent order, and now
that is no longer offering RALs, they want all three of our banks out of the RAL

business ASAP. 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 told him that and **Gruenberg** wanted the FDIC banks to stop offering RALs. ⁵² explained that he believed their rationale was that banks offering RALs were declining in number, and 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.

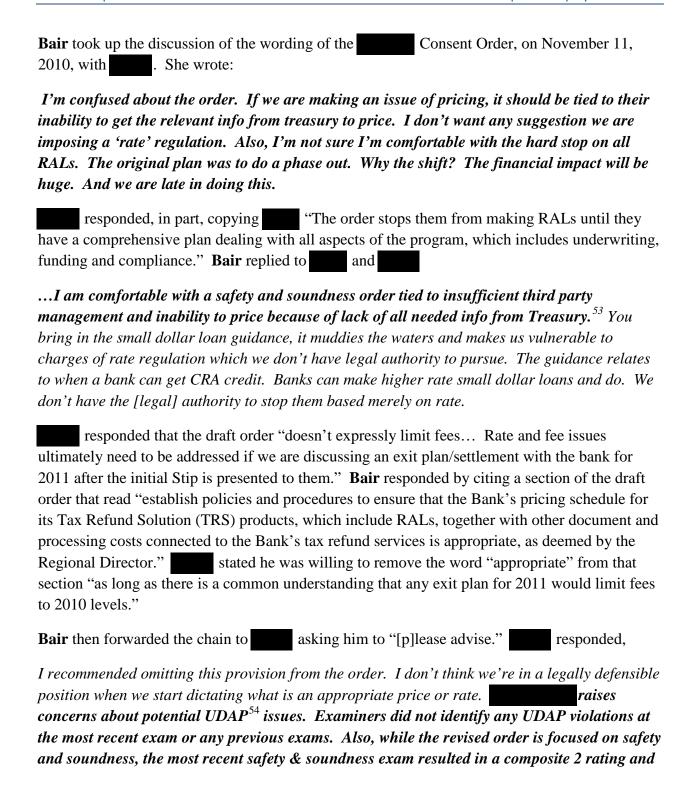
It is noteworthy that sent **Bair** a copy of the draft Consent Order and included a portion of the text in an email for her to review specifically. The text was as follows:

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.

SENSITIVE INFORMATION - FOR OFFICIAL USE ONLY

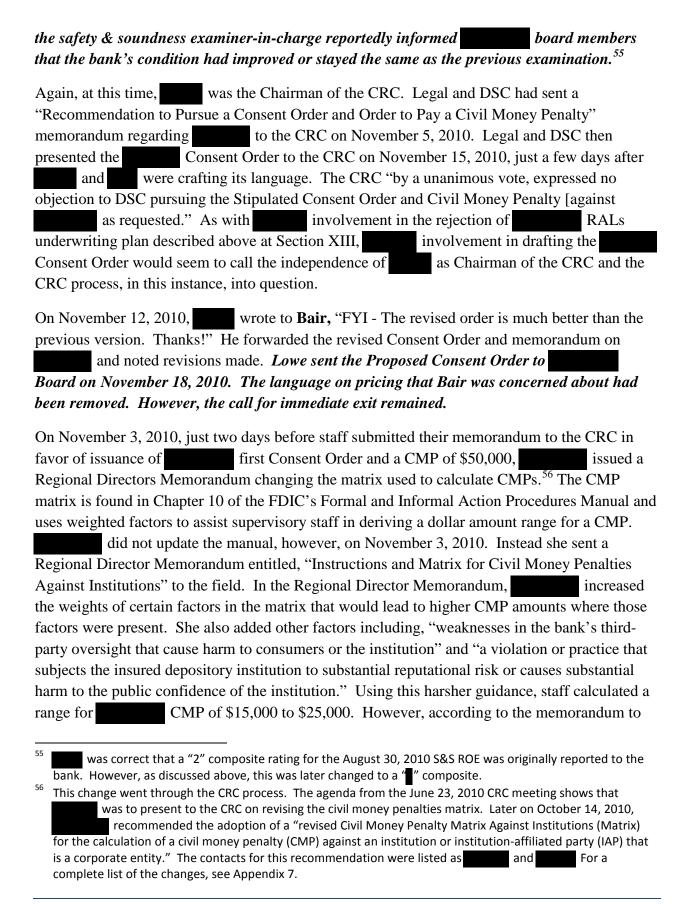
told us that then-Chairman **Bair** made it known in a meeting that she did not like RALs, but that she was not telling DSC what to do. said that **Bair** told staff to do what they needed to do. also told us that then-Vice Chairman **Gruenberg** did not like the RALs product. stated that DSC was under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



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 on February 9, 2011.

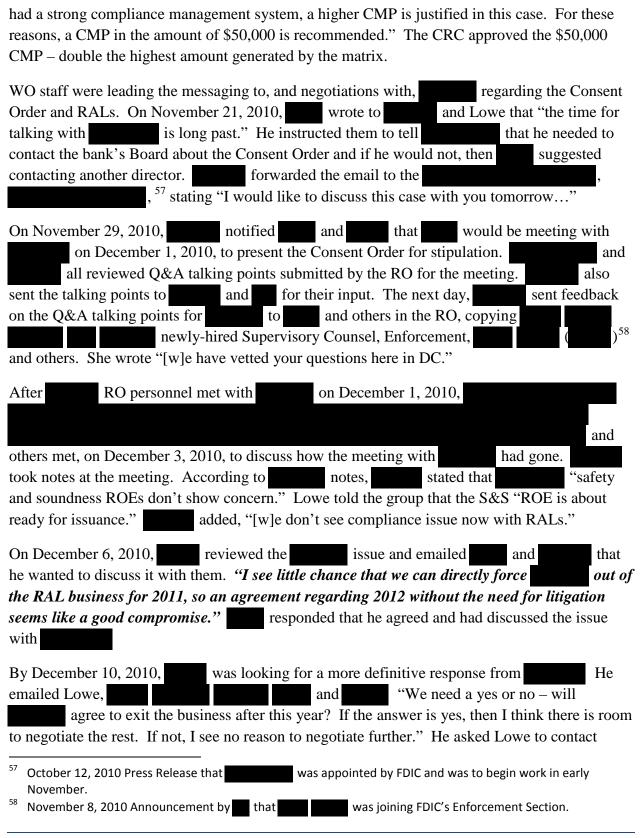
SENSITIVE INFORMATION — FOR OFFICIAL USE ONLY

[&]quot;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.

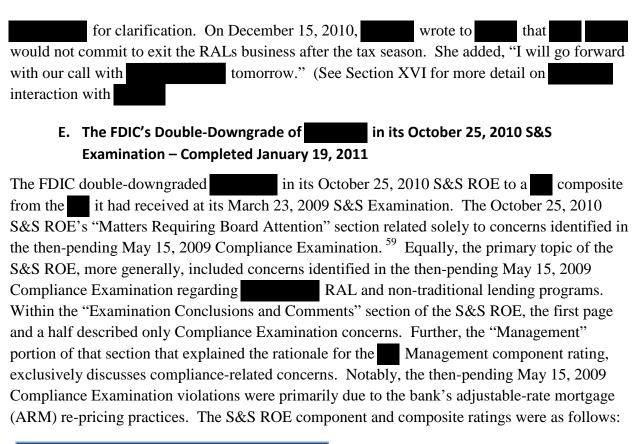


the CRC on November 5, 2010, regarding the

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



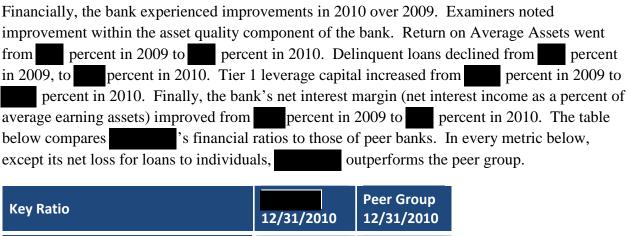
Component	Rating
Capital	
Asset Quality	
Management	
Earnings	
Liquidity	
Sensitivity to Market Risk	
Composite	

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 some 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 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 , See Appendix 5.

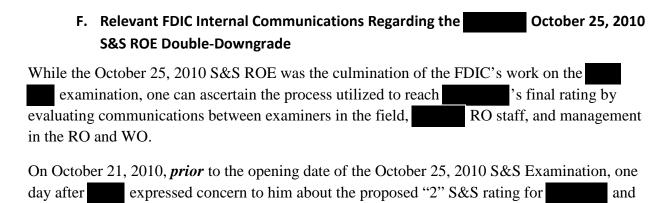
compares the bank's interest earning assets (*i.e.*, loans to customers, investments, etc.) to liabilities (*i.e.*, deposits, notes payable, etc.). A weakened net interest margin puts earnings pressure on the bank to support its operations.



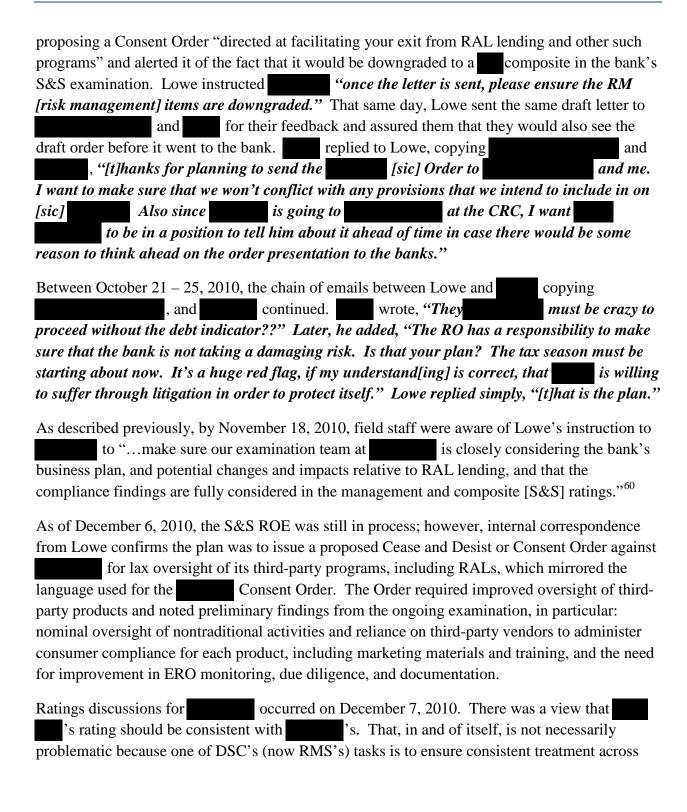
Key Ratio	12/31/2010	Peer Group 12/31/2010
Return on Average Assets		
Net Interest Margin		
Tier One Capital		
Net Loss to Avg. Total Loans		
Net Loss for Loans to Individuals		
Net Loan Growth		

Source: 2010 Uniform Bank Performance Report for

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.



in light of weaknesses identified in the then pending May 15, 2009 Compliance ROE, Lowe sent a draft letter addressed to to his staff. The draft letter told the bank that the FDIC was

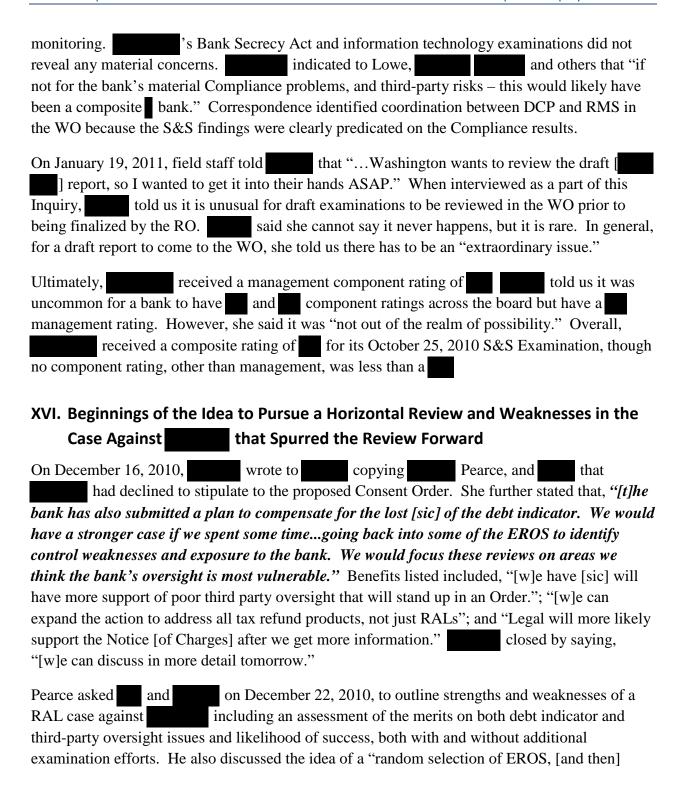


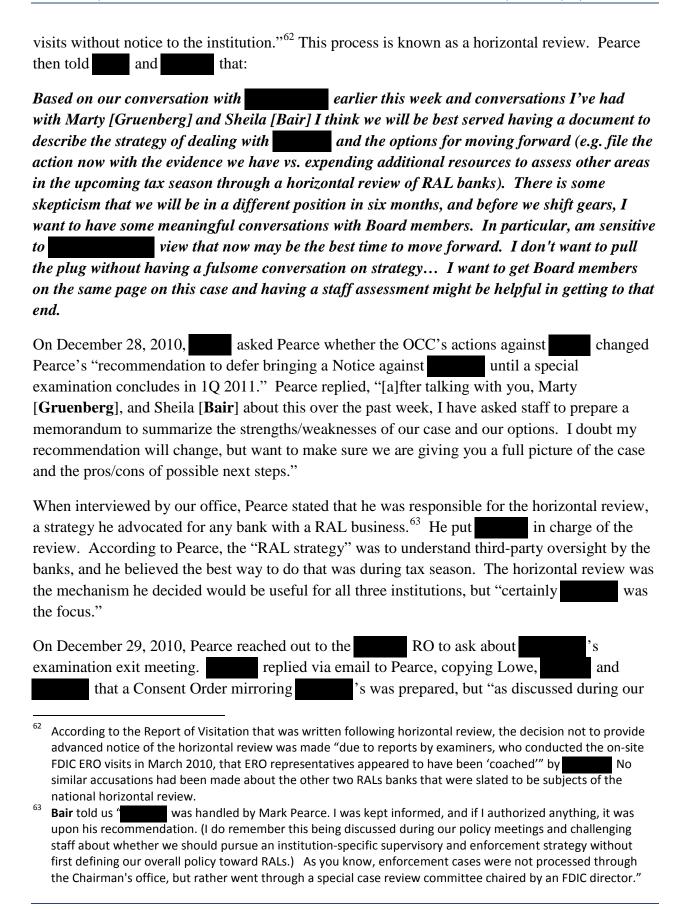
⁶⁰ Email from Lowe to no subject, November 2, 2010.

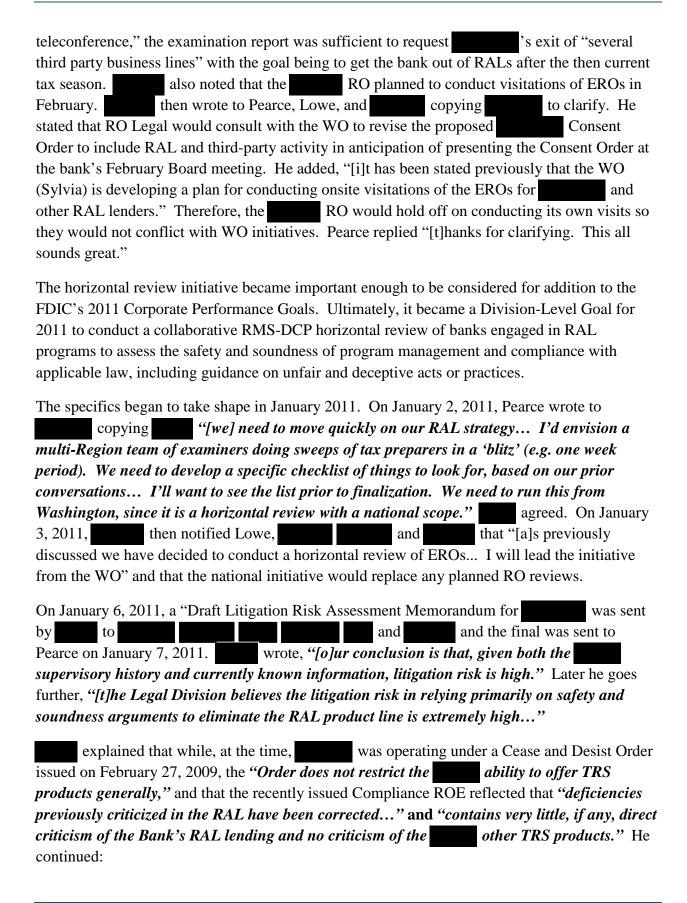
the institutions it supervises. 61 At this juncture a composite rating was discussed, rather than
the composite rating that the examiners and first-line management had initially wanted
because, according to them, "there are other factors at play here;" and "[c]onsidering what has
transpired with (very political), I'd be surprised if we go with a composite especially
since has pretty strong controls and oversight of their programs, and is
severely lacking. — is getting an overall — based on risk management findings alone it
would be a composite ;" and "there may be other agendas or politics in play at the RO senior
management level" On December 8, 2010, wrote to and that
"[g]iving a composite seemed like an enormous stretch based on the overall exam
findings. I don't think it will be a big stretch to make a ."
On December 27, 2010, an examination exit meeting was held with the bank's management
regarding 's Compliance ROE. 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, stax products accounted for 66 percent of
the bank's income as of June 30, 2010. As of December 30, 2010, see Section 's ROAA was 1.32
percent. Income generated from the RALs and the made up about 70
percent of the total ROAA. The May 15, 2009 Compliance ROE was completed and mailed to
on December 30, 2010. However, UDAP matters remained pending and were under
review by the WO, with placeholders left in the report. The 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, emailed Lowe, copying and others, and noted
that examiners had found no major concerns during the S&S Examination for . By
this point, the EIC had conceded to the ratings; 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 email, it appears the bank maintained a strong balance
sheet. The Bank's Tier leverage capital was approximately percent, and classifications
approximated percent, a decrease from the previous S&S Examination. The bank's liquidity
was strong, with moderate sensitivity that examiners felt management was adequately
The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions
Examination Council (FEIEC) on November 13, 1979, and undated in December 1996, "Over the years, the

(BASIC EXAMINATION CONCEPTS AND GUIDELINES, Section 1.1)

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."

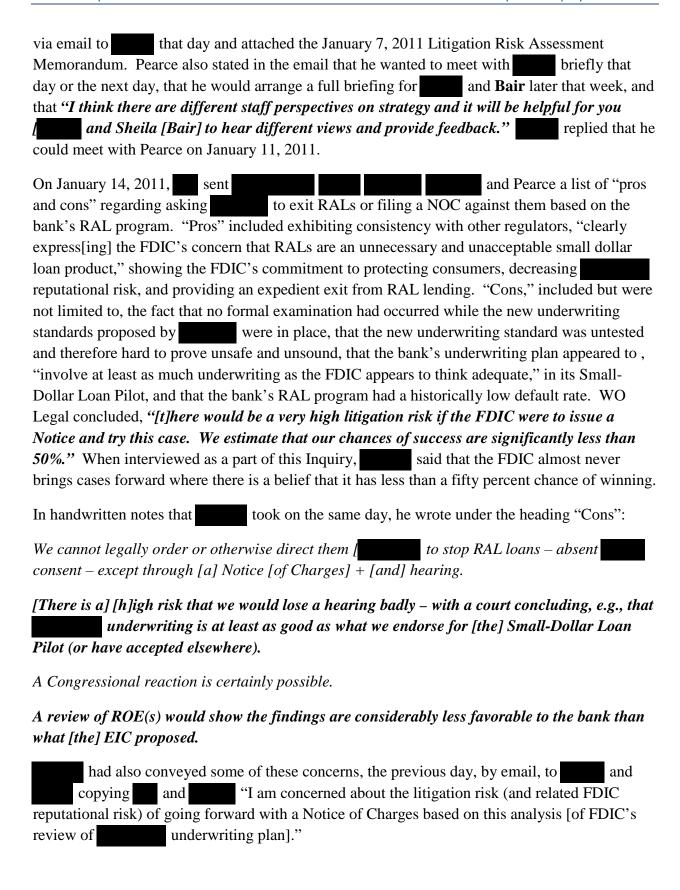






authority with regard to issuance of a Cease and Desist Order... Generally speaking, while section 8(b) allows for imposition of an order requiring corrective action or affirmative relief, the remedy sought by the FDIC must have a reasonable nexus to the complained of violations or practices. concluded, "[t]here is a very limited nexus between these concerns and the 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. further concluded, "[b]ecause of the substantial litigation risks from proceeding with a Notice of Charges against 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, wrote to the , Pearce, and went further than did in the memorandum. " 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." also explained, on January 7, 2011, that the FDIC's position with respect to differed from the OCC's with "OCC told 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. submitted at least two plans that were deemed 'unacceptable'" and pointed out that the FDIC ultimately agreed to exit the business at the OCC's request. had not yet analyzed the plan submitted by was not willing to voluntarily exit the business. On January 7, 2011, Pearce wrote to and copying "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 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 the horizontal review, and strategic options, including goals. emailed Pearce, following up on their December 28, 2010 On January 10, 2011, exchange, about when could expect the options memorandum. Pearce replied

Section 8(b) of the Federal Deposit Insurance Act, 12 U.S.C. §1818(b), sets forth the FDIC's

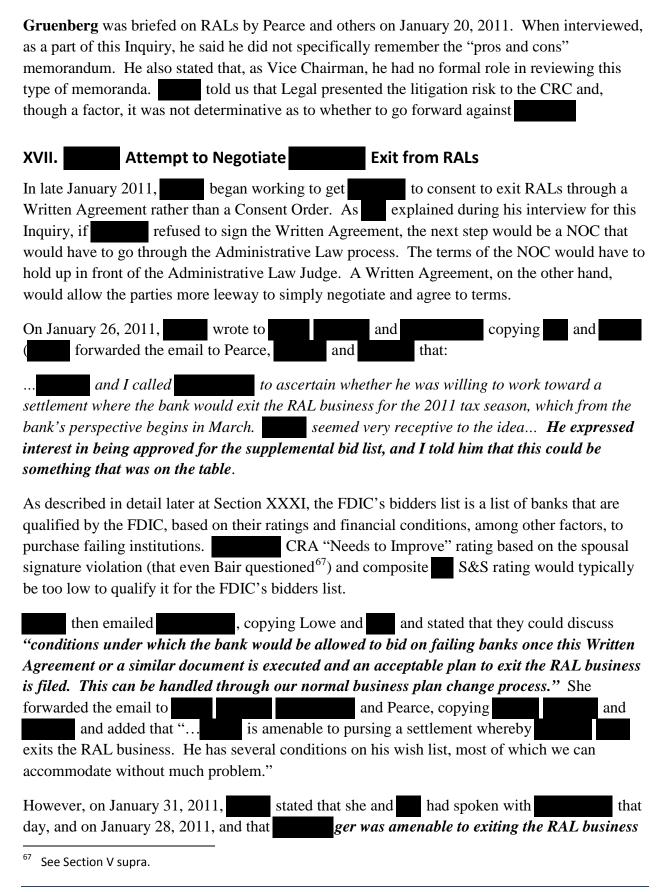


told us that she was aware of the legal "pros and cons" of bringing an enforcement action against because she was working with on the issue at the time.
against because she was working with on the issue at the time. agreed that there were many more cons to taking action against and stated that she agreed with all
of cons. When asked why they continued to press regardless of all the cons, she said that
was what her supervisor, wanted and again cited the rhetorical question regarding
- if that size bank cannot manage RALs, how could ?64
replied to the group above on email with additional "pros" for them to consider. believed that action was supported by, among other things, "a specific finding from FDIC examiners who are credible retail credit experts," 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 agreed to settle and exit the RAL business.
Then on January 16, 2011, discussions turned to what would be said at the Board
meeting, scheduled for January 19, 2011, to cover both the Compliance and S&S ROEs. stated to and Pearce, copying that would "express disappointment"
that there was no agreement to exit RALs and say we are considering other options."
On January 17, 2011, wrote to that the would support DSC with respect to the actions they wished to take against 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 [and Mark's [Pearce] call." shared view. On January 20, 2011,
, and Pearce were included on an
email chain about the draft letter to asking them to exit RALs. When the discussion
turned to next steps should the bank refuse to exit, 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 RAL program was problematic, wrote to
Pearce, and that "will not cease his RAL"
program" and it "is up to him to demonstrate that this is not unsafe or unsound."

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 was able to adequately manage the risks of its RAL programs.

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

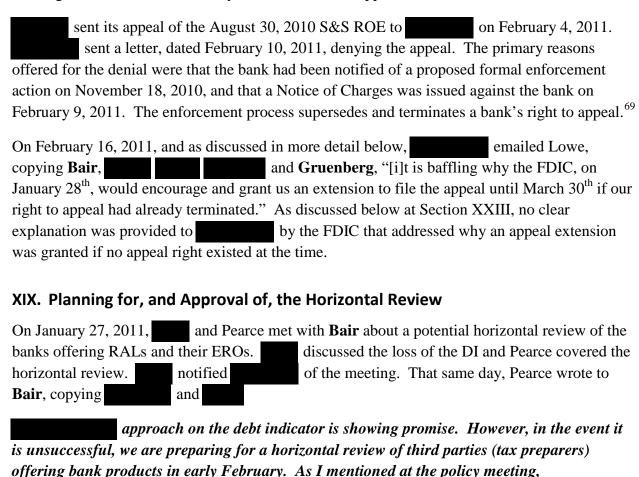
According to the RMS Manual of Examination Policies, "...mere suspicion is not sufficient grounds to institute this enforcement proceeding. Any such action must rationally be based on facts and evidence, as the FDIC has the burden of proving formal charges set out in a Notice of Charges."



if his conditions were simultaneously met which "is simply not workable." 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, told us that ger, in their very first conversation, told her he to be on the bid list for failed banks. She believed she had told that to do so, 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 wanted it in writing that if exited, it would get on the bid list. said that she could not make such a promise. believed the bank's RAL business was the primary issue causing problems for the bank and that if was to "get rid of the offending issue" it would be fine, as it was an otherwise well-run institution. she did not promise a ratings upgrade, but she said that it stood to follow that if exited, "everything else would be good." XVIII. Appeal of the August 30, 2010 S&S Examination On January 24, 2011, sent a letter to acknowledging that the bank had received the August 30, 2010 S&S ROE on December 2, 2010. by that time, had also received a proposed Consent Order, on November 18, 2010, relating to its TRS business. In his letter, addressed, among other issues, the disparity in rating between the FDIC's composite rating for the bank. He also rating and the State of composite had recommended a composite noted that the 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, sent a letter to copying alerting them that planned to appeal the composite rating. He also requested additional time (until March 15, 2011) to do so, given settlement negotiations between the bank and FDIC were granted 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



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

have time available – 15 minutes should be enough. If you have concerns on our approach,

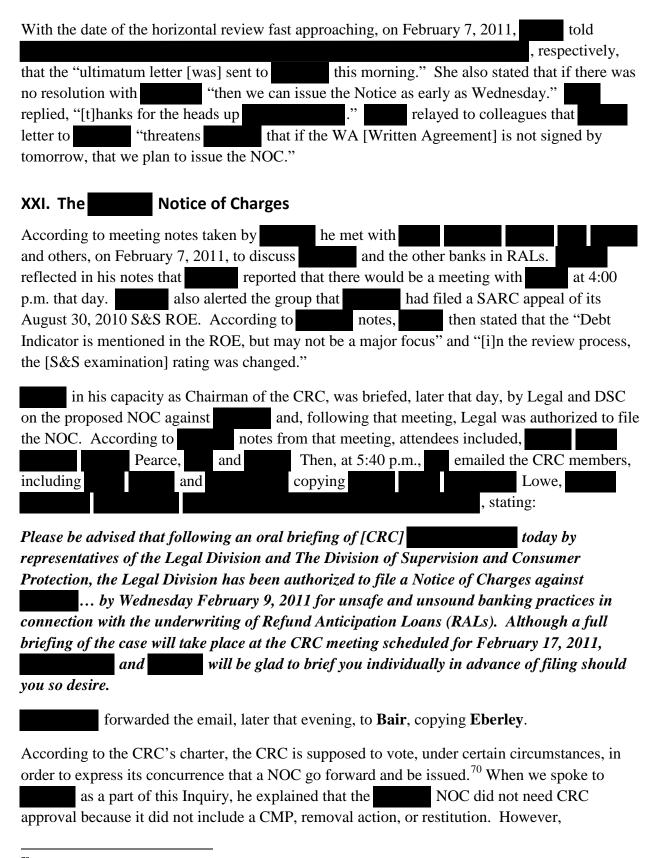
it'd be good to flesh them out before examiners and legal ramp up the final planning.

and I would like to brief you on this as soon as you

resources required to do this well,

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.

On January 28, 2011, Pearce briefed and and 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." replied that the review would be pushed back until after the Board meeting, scheduled for February 14, 2011.
On February 3, 2011, updated Pearce on the status of actions with respect to the three RAL banks. Then, on February 4, 2011, 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 Pearce, and others.
XX. Continued Efforts Toward a Written Agreement with
At the end of January and into February 2011, continued her efforts to settle with as the horizontal review was being planned in parallel. This effort included continued consideration of a written agreement. On January 31, 2011, wrote to "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, informed "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." also made clear in an email to Lowe, Pearce, and copying and others that they had all agreed that "we are not planning to go after any of other tax related products if they agree to exit the RAL business."
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. Wrote to Pearce, 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 with a with this bank 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]." took steps to that end on February 5, 2011. She revised a draft letter to regarding RALs to deemphasize the link between signing the Written Agreement to exit the RAL business and the bank being added to the FDIC's bidders list. Specifically, she told 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."

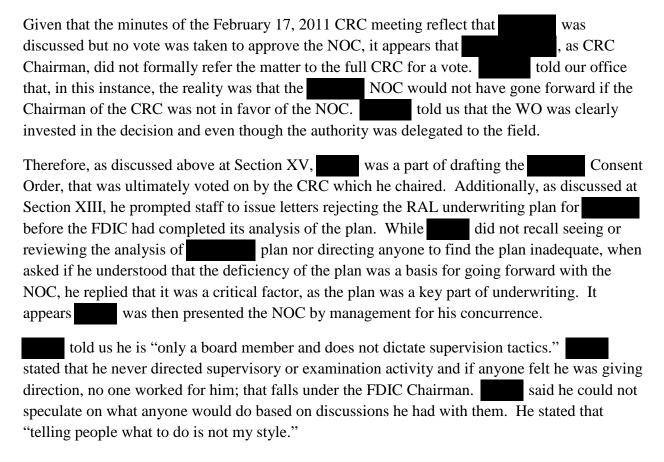


⁷⁰ FDIC Board Resolution Seal No. 061427 as amended; FDIC Board Resolution Seal No. 074120 as amended.

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

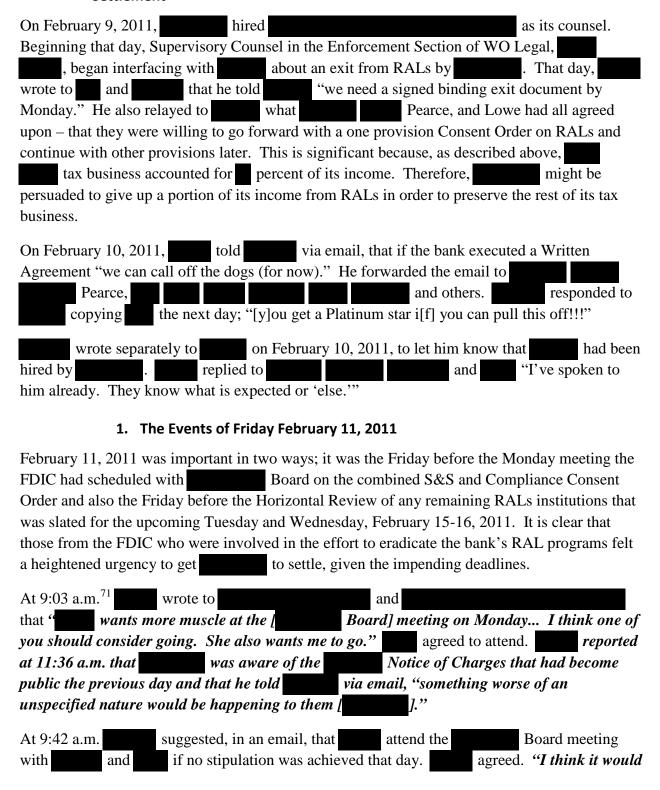
FDIC Board Resolution Seal No. 07227, Section B "<u>Functions and Duties</u> The Case Review Committee Shall -" part (2) reads:

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.

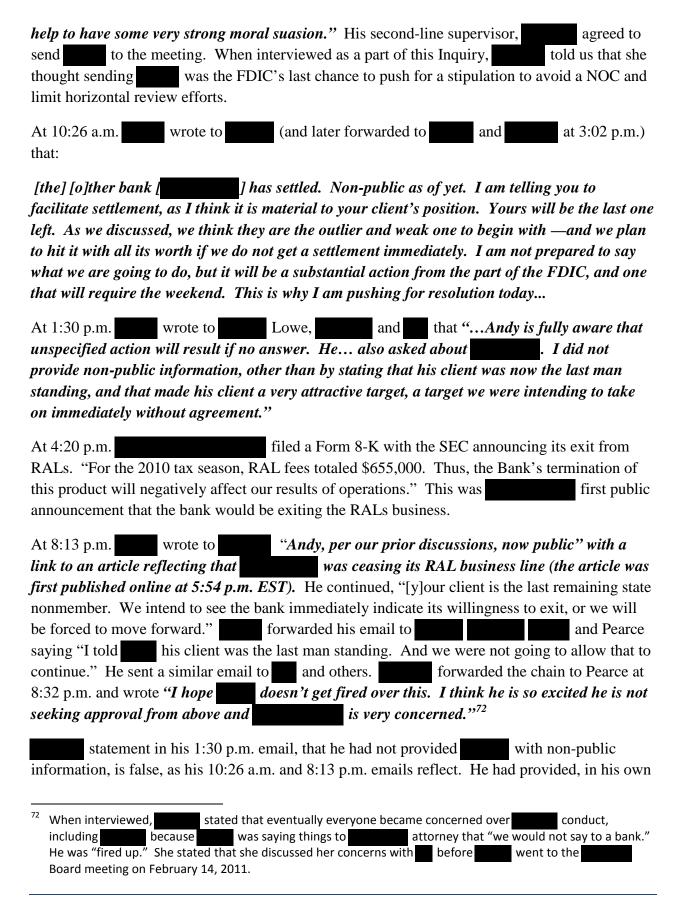


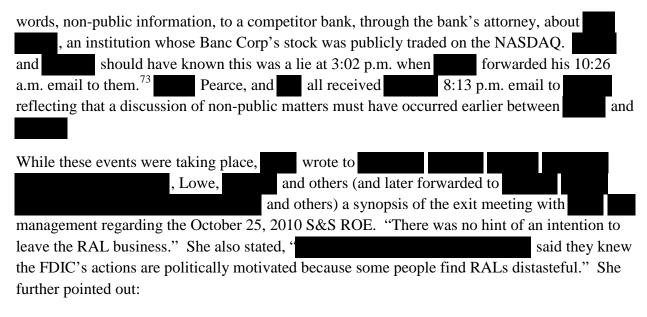
XXII. The Final Push to Get out of RALs At the end of 2010 and beginning of 2011, the FDIC was also working to get abandon its RAL business. This effort was executed by the same FDIC personnel that had spurred the push against Consent Order Versus Written Agreement On November 18, 2010, sent Lowe and a draft Consent Order and provided a list of findings regarding the bank's lack of third-party oversight. Like the draft Consent Order, the draft Consent Order for 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 Consent Order, the draft Consent Order was vetted in the WO. On the same day Lowe received the draft from he sent it to for her review and approval of next steps. A more formal memorandum followed, on December 10, 2010, from which requested consultation and concurrence on the to proposed Consent Order. A revised draft Consent Order was sent to on January 5, 2011, for their review. then sent the draft to and Pearce, and others on January 31, 2011. That same day, sent additional edits to copying Consent Order to and others that "incorporated the draft forwarded it to Pearce and told him "I will get suggestions." approval and send to region in a.m." Then on February 2, 2011, sent a copy of the Consent Order to and with a note that stated that they were "directing them to "Thanks." submit a plan to exit the RAL business." replied to On February 3, 2011, the FDIC delivered the proposed Consent Order to 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 reported, on February 10, 2011, that " said he prefers to have a Consent Order," a Written Agreement was also drafted for wrote to Pearce, copying about the Written Agreement that day. "Is this something and/or the Chairman's Office need to know about before it is finalized?" 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 and thus would not then responded to all that "I concur with be surprised by one for comments and will ensure that is informed."

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



All times are provided in Eastern Standard Time.





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 Violation⁷⁴

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

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

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

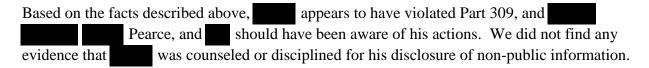
The Right to Financial Privacy Act protects customer financial information from being transferred from one federal authority to another.

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:

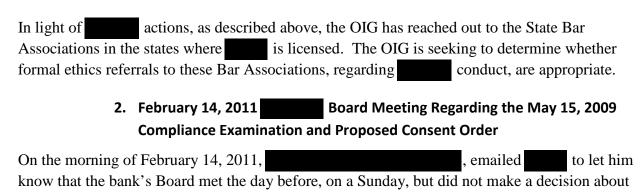
No person shall disclose or permit the disclosure of any exempt records, or information contained therein, to any persons other than those officers, directors, employees, or agents of the Corporation who have a need for such records in the performance of their official duties. In any instance in which 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.



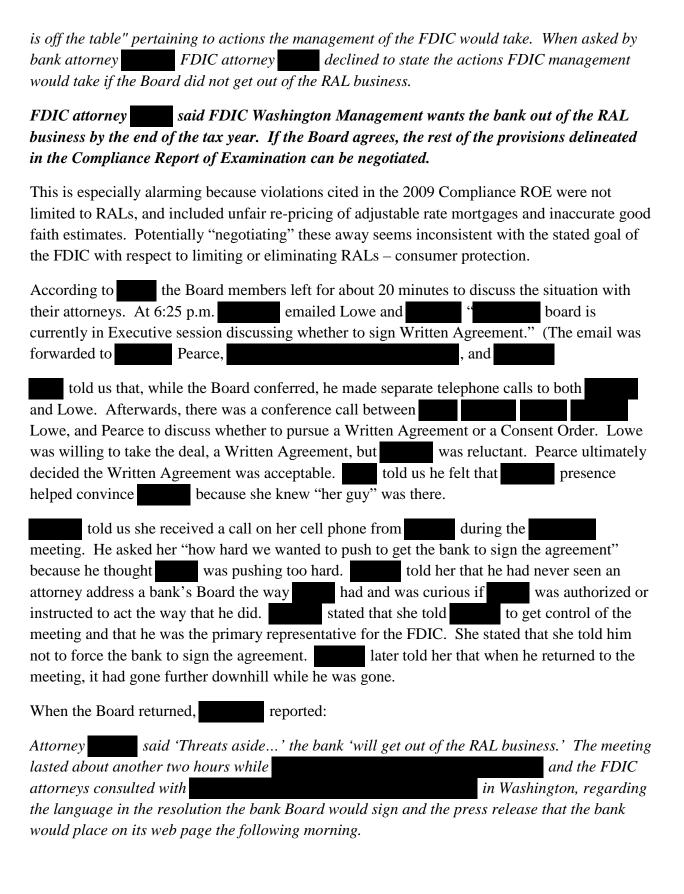
b. Potential Securities Law Violations

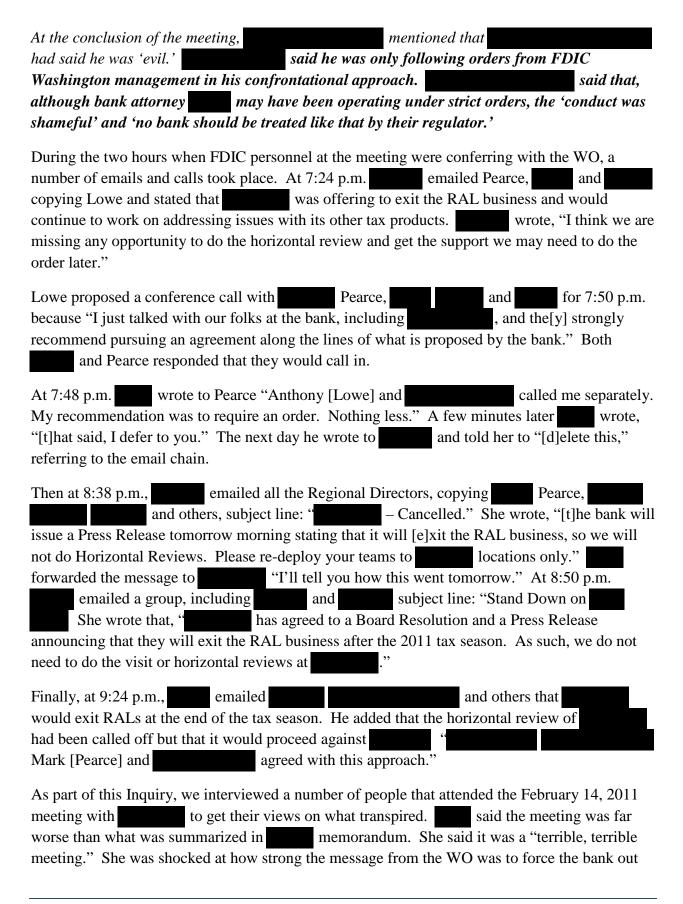
The nation's securities laws prohibit trading on insider, or non-public, information. Because non-public information was shared outside the FDIC about an insured institution whose holding company's stock was publicly traded, the OIG has referred this matter to the SEC and alerted the Department of Justice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

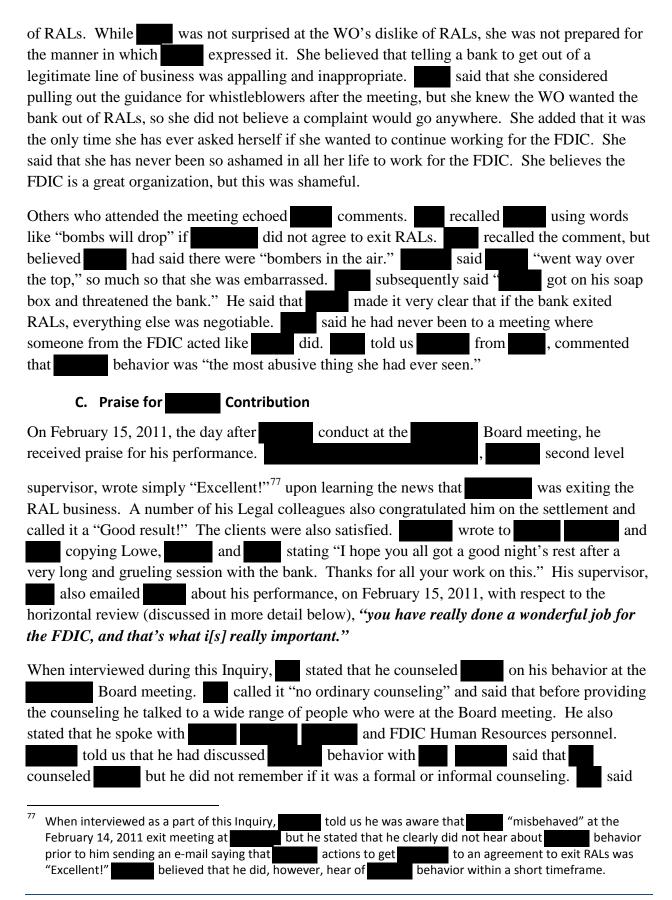
c. Potential State Bar Association Referrals

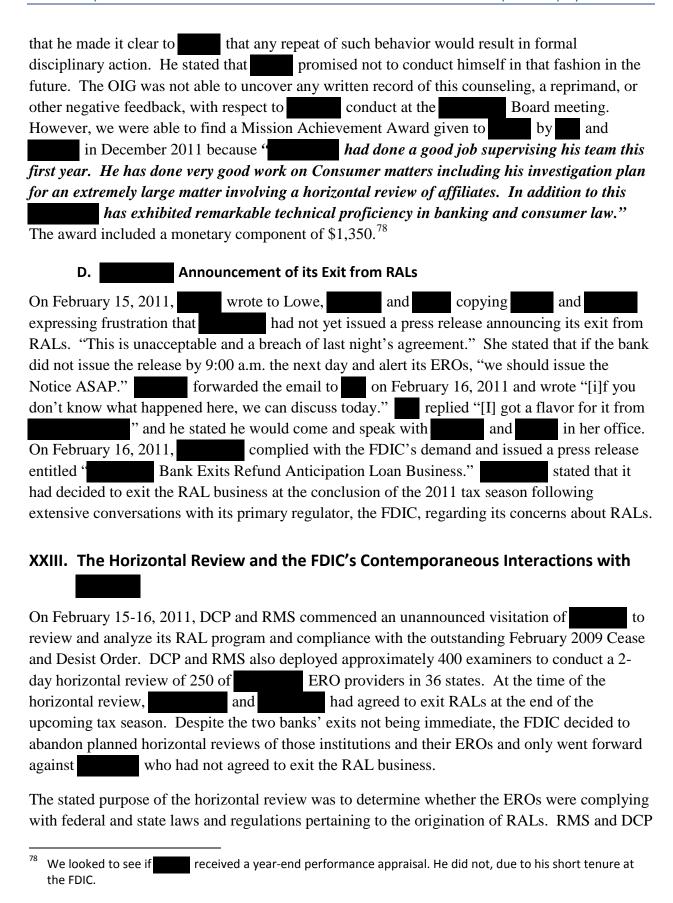


exiting RALs, so that day's scheduled meeting between the bank and the FDIC wou proceed. The replied to "[t] o prepare your clients, nothing less than a de agreement with them today will be needed to avoid further action." Despite February 10-11, 2011, he continued acting as a representative of the FDIC with was sent, in that capacity, to the FDIC's meeting with the bank's Board on February discussed in detail below.	finitive conduct on and
The rest of us are all in agreement." She replied, "[u]nderstood completely. Will we have replied, "[t]hank you. We will 'gitter done." told us that even though the opinion from at the time, was that the FDIC did not have enough to file a DCP had a "keen belief" that the horizontal review would provide the am	ter if r the results o go ahead oard with this. vork on it." he Legal NOC against
The FDIC met with Board and some of its executives that afternoon to May 15, 2009 Compliance Examination results and the proposed Consent Order. To counsel, was also in attendance. FDIC representatives from RMS, DCP, and represented the created a summary of the meeting, which was loaded into RADD.	he bank's
Once the results of the Compliance Examination were presented, wrote that:	
then began by stating that management at the FDIC in Washington would full force of the Corporation to bear against the bank if the Board of Directors did immediately agree to cease offering RALs at the end of the 2011 tax season. He swould be immediate consequences, beginning the next day, unless the Board agree offering RALs. When asked, FDIC attorney did not answer why the immediate was necessary although the FDIC was aware that the bank had been offering RALs with no detrimental effect on the bank or any customer. FDIC attorney said	d not said there sed to stop iate decision
DSC was split into two divisions, effective February 13, 2011, – the Risk Management and Super (RMS) and Division of Depositor and Consumer Protection (DCP). The latter would be headed by was named as Board were satisfied with the performance of Pearce and	y Mark Pearce.



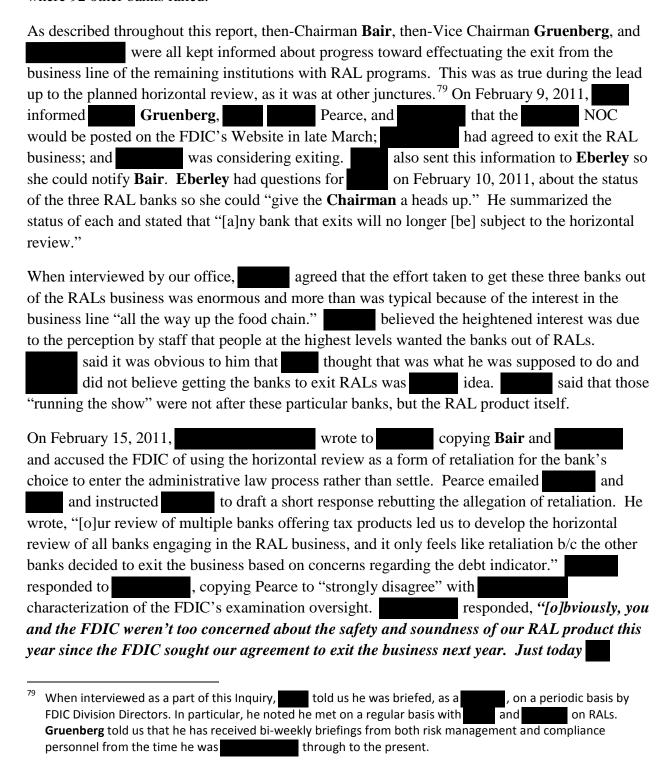


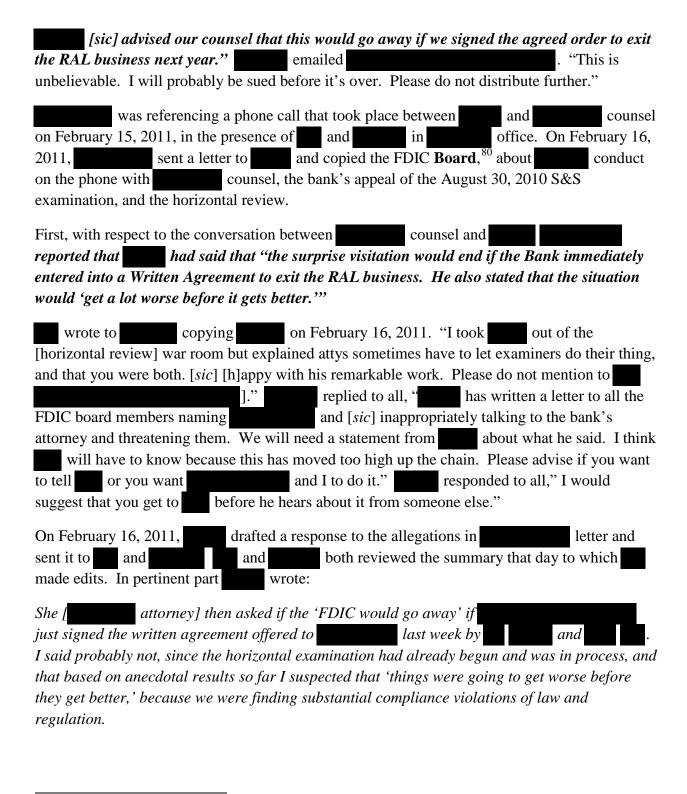




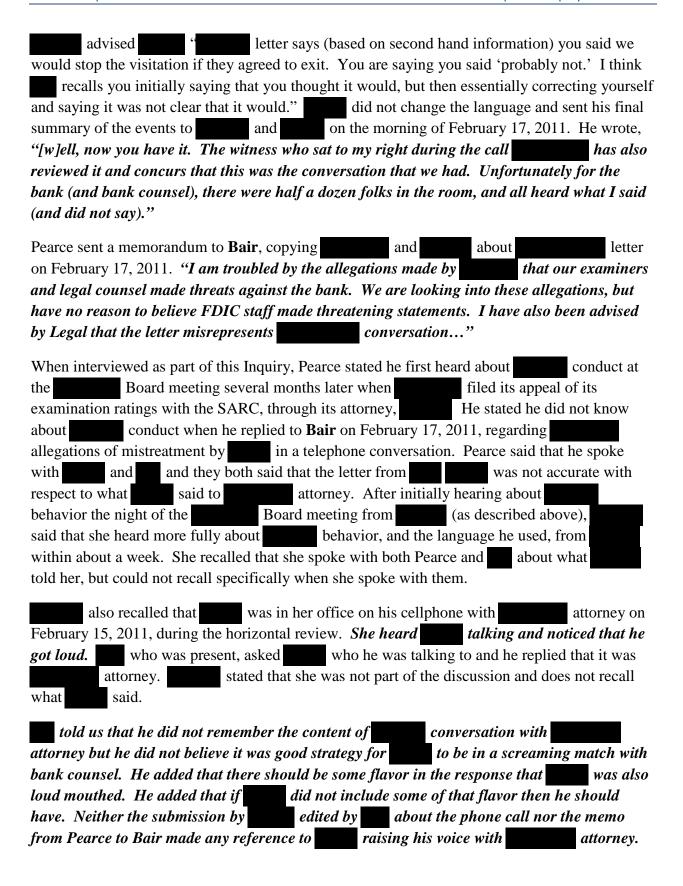
SENSITIVE INFORMATION - FOR OFFICIAL USE ONLY

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.

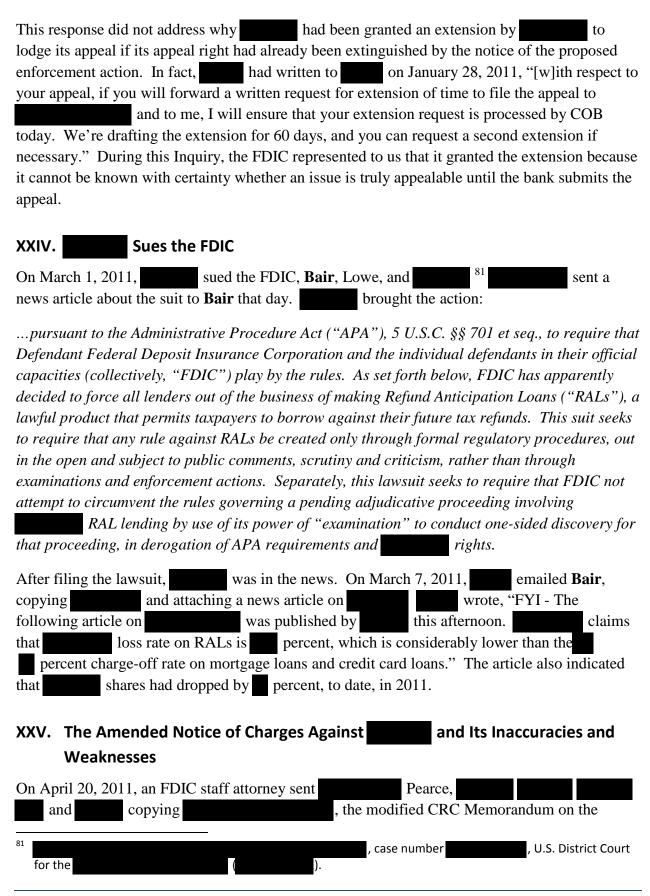


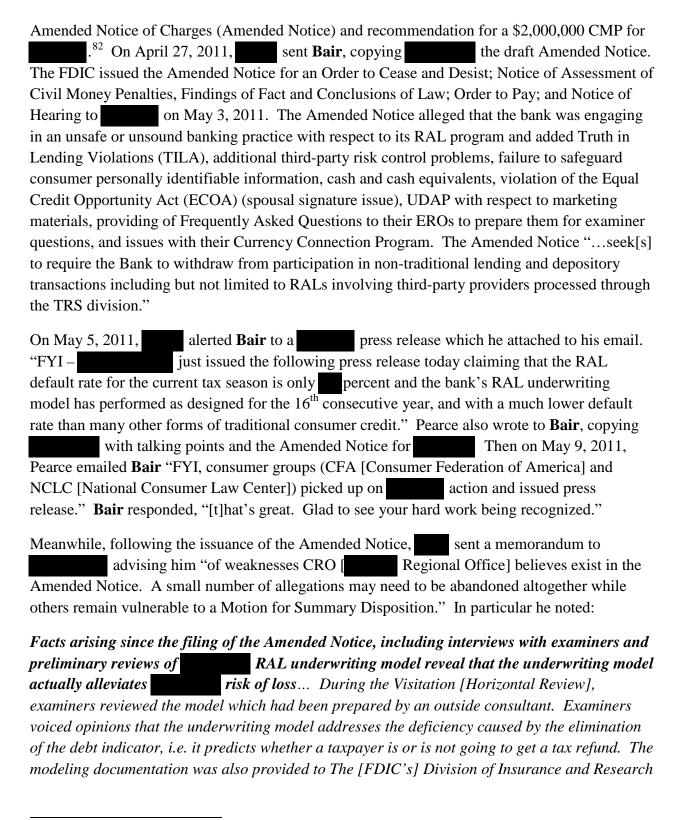


When interviewed by our office, **Gruenberg** stated he did not recall receiving the letter from told us that he may have heard about conduct after the fact. stated that although he was copied on the letter the bank sent to the FDIC Board members, the FDIC is "Chairman centric" and all letters go to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

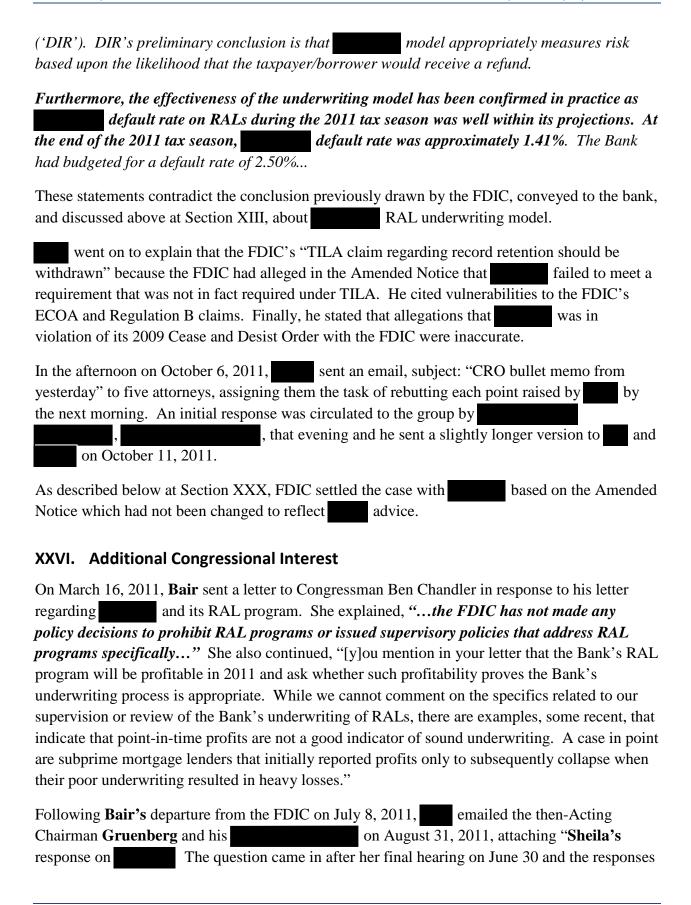


also told us that she, and Legal composed the February 17, 2011, memorandum from Pearce to the Chairman.
appropriate response. She stated that "you do not let a bank accuse you of retaliation." It seems implausible given that (1) reported to Pearce; (2) was aware of conduct at the Board meeting; (3) was present when got loud" on the phone with attorney; and (4) assisted Pearce with drafting the memorandum to the Chairman about phone call with among other issues, that would not have relayed the nature of behavior to Pearce. Equally, at the time, Pearce, and had all received emails, on February 10-11, 2011, in which said things to attorney that "we [the FDIC] would not say to a bank" and used non-public information in an attempt to leverage a settlement with yet none of this information was included in the memorandum to Bair .
In addition to conduct, the other issues raised in February 15, 2011 letter and February 16, 2011 email to Lowe, copying Bair , and Gruenberg included appeal of the composite rating of the bank's August 30, 2010, S&S examination and the horizontal review. In the February 16, 2011, email, explained that had not received the FDIC's letter, dated February 10, 2011, denying its appeal until Lowe attached it in an email that day. 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 28 th , would encourage and grant us an extension to file the appeal until March 30 th is 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 email to and Pearce and wrote, "I don't understand???" replied,
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.



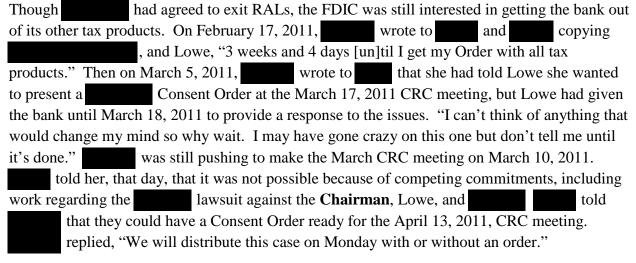


As with the CMP recommendation to the CRC with Consent Order (see Section XV above), staff basically doubled the amount generated through the use of the matrix. In this instance, the derived amount was \$1,057,208. However, staff recommended, and the CRC approved, \$2,000,000.



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. had also forwarded an email he received from Pearce to then-Acting Chairman **Gruenberg** and on August 29, 2011, subject " timeline." The email read, in part, "[o]ur horizontal review of RAL providers (including a visitation to) occurred on 2/15/11. It was reported in an American Banker article filed a lawsuit in district court [against the FDIC]. We amended our on , after Notice of Charges on 5/3/11, reflecting the results of the visitation."

XXVII. The Consent Order

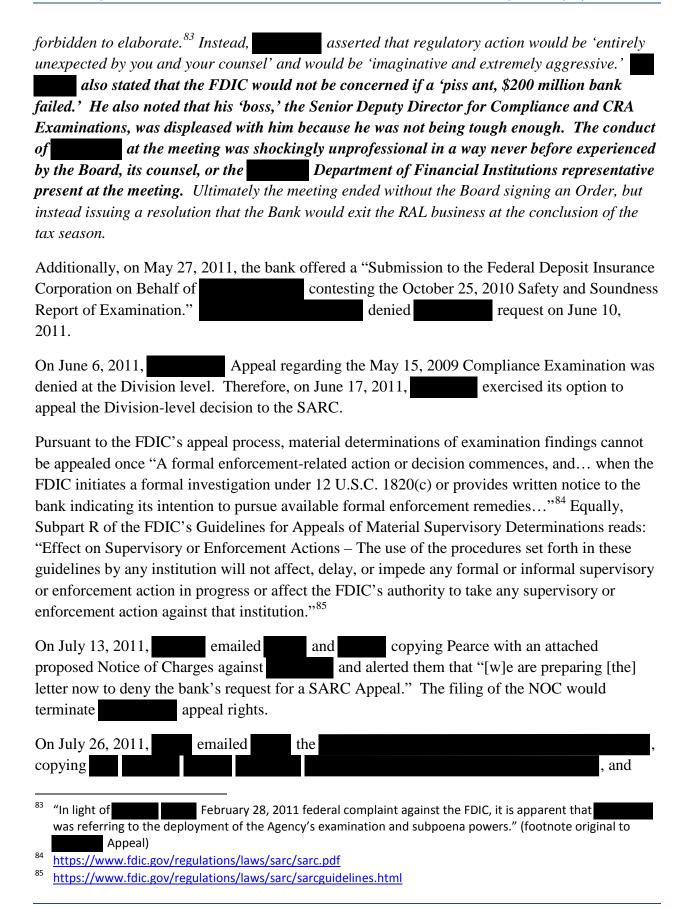


On March 13, 2011, sent copying , a Draft CRC Memorandum on . relayed to that the draft had gone to Pearce and told him to provide changes, if he had any. "This memorandum requests authorization to accept a stipulated Consent Order, as well as pursue an Order of Restitution and an Order to Pay a Civil 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."

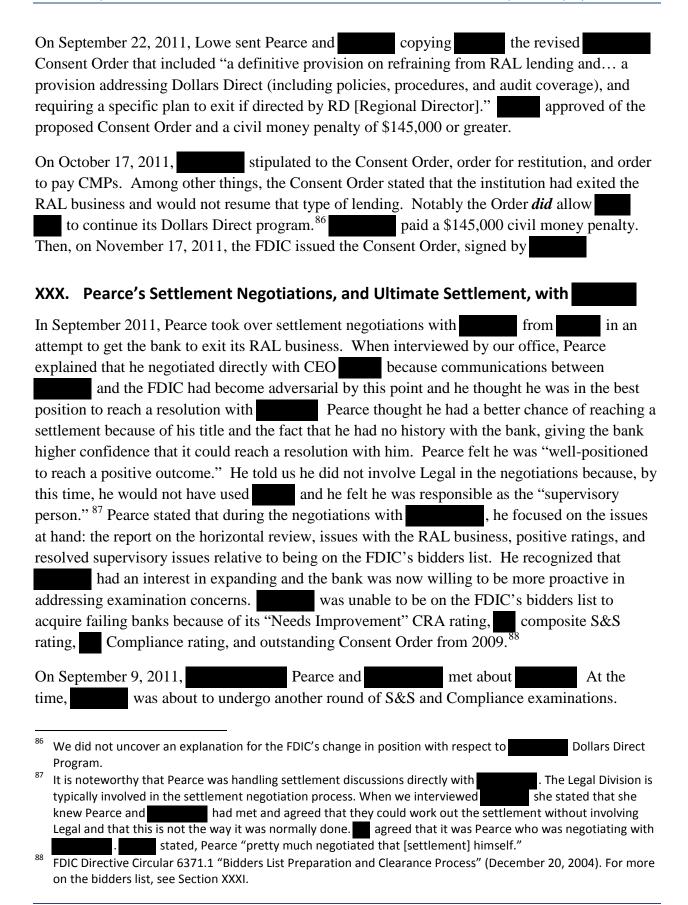
The Consent Order for was presented at the March CRC meeting. On April 1, 2011, **Bair's** representative on the CRC wrote to her, copying

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 '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:
According to the Regional office, the rating for the management component as well as
the overall composite 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
) 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 and respectively, and
also considering the bank's previous (2009) CAMELS rating of
Bair responded to "No. That doesn't sound right." replied, "[o]f course, the
rating for S&S means much higher deposit insurance assessment for the bank."
provided Bair with additional specifics on April 5, 2011, "the overall downgrade from
a to a rating for safety & soundness results in a four-fold increase in the bank's
assessment – from per quarter to per quarter." Bair forwarded her discussion
with 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 who would respond to Bair . We searched for, but
did not find, an additional written response from either or Pearce to Bair on this issue.
When we interviewed he recalled being in the CRC meeting, sometime prior to April 1,
2011, when the case was presented. At the meeting, he asked about the
composite rating being downgraded from a to a 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 if she could provide examples of any
similar situations and she could not provide any. After that meeting, they rarely spoke.
opined that the double downgrade seemed "petty, vindictive, and unprecedented."

Appeals of Its May 15, 2009, Compliance and October 25, XXVIII. 2010, S&S Examinations Board met with the FDIC. The official account of the meeting On April 11, 2011, 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 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..." requested a review of material supervisory determinations relating On April 25, 2011, to the Compliance Examination dated May 15, 2009. This was the bank's first line appeal to the Through their attorneys, including 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, became directly involved in communications with the Bank and its counsel. 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. 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 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, 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... 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 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. refused to provide any details and stated that he was

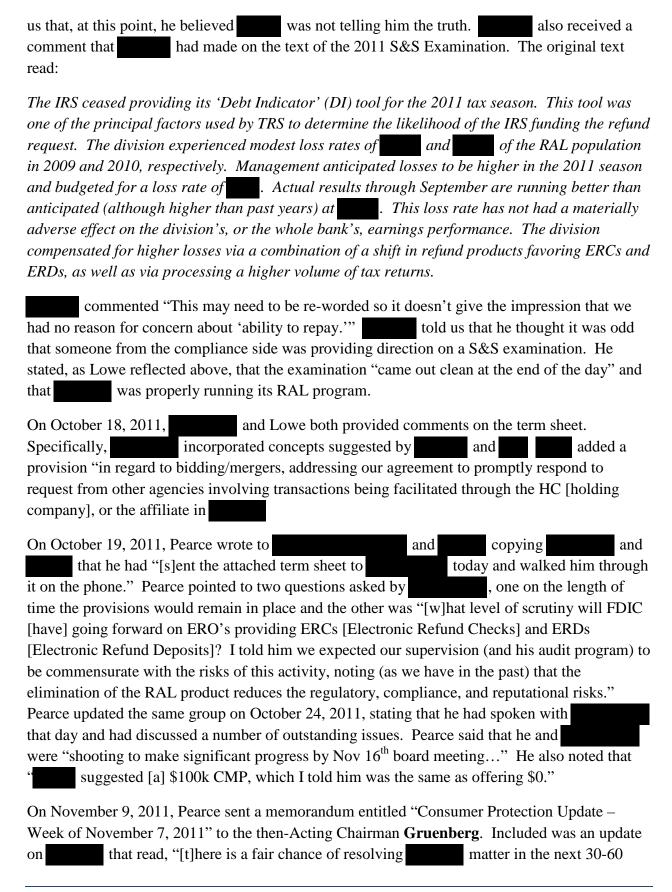


others, attaching letters from DCP and RMS denying SARC appeals. He also
attached DCP and RMS appeals that he stated were previously circulated on June
20, 2011. forwarded the email to Pearce on July 30, 2011, saying the "[A]cting
Chairman had not yet signed these letters," though the letters were drafted for signature by the
Executive Secretary. Regardless, this reflects that, the then-Acting Chairman's office had the
information put forth by in its appeals, including information about conduct.
When we interviewed Chairman Gruenberg , he stated that he did not recall reading
appeal, never met and had never heard of him prior to this Inquiry. The FDIC further
represented to our office that did not acknowledge the July 26, 2011 email, print or read it
contents, or forward it to Gruenberg .
Pearce also told us that, in August 2011, he traveled to to meet with
executives and some of its Board members regarding the way they were treated by
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
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 conduct toward
contemporaneously with his interactions with the bank, some found out soon afterward, and no
later than July 2011, five months before 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
Between September 2011 and November 2011, the FDIC changed its position on
. As described previously, the 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, and Pearce. Initially, Lowe wrote to copying Pearce, "[d]uring the call with on [sic] yesterday,
we advised of no change in our position relative to the , and that the bank
should make plans to exit [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 . However, 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 are connected in anyway."
Lowe responded, "[a]gree – no connection at all."
1 / 2 10



According to notes from the meeting, Pearce reported the he had met with and and that "is looking forward to 'good'[examination] reports." 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 notes from that day, the FDIC's economists in its Quantitative Risk Analysis Section had determined that 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 before the tax season and, in fact, their default rate has been approximately	
notes from the September 9, 2011 meeting also document comments from Pearce as follows: "Horizontal review demonstrates that they [
On September 30, 2011, Pearce wrote to , "I spoke with to resolve the outstanding issues related to the notice of charges and believe there is a meaningful prospect for resolution." Pearce explained that 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"	ul
On October 6, 2011, Pearce organized a conference call with about a strategy for Topics included "RAL program" an "Bidder List" among others. According to notes taken by and also attended. The notes reflect that stated she "[w]ould not be 'outraged' if [the] Debt Indicator [issue was] dropped out of the case." 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." responded, "[w]hat do you win? Do we get an order saying 'no more RALs'?" Pearce then discussed the terms of the settlement and "[w]ill brief CRC on this next week." Lowe stated that, "[o]n RMS side exam is looking pretty clean." added, "[s]eeing some compliance issues, not tied to RALs. Still looking at it." Lowe replied, "[l]et thrift [? f

Then on October 16, 2011, emailed Pearce, and Lowe, copying and explaining and attaching a draft settlement term sheet for for their review. Notably with respect to mergers, acquisitions and bidding proposed the following language:
After April 20, 2012, the FDIC will permit to join the bidders list for failed banks and will consider applications for acquisitions or mergers, provided that: a) has fully complied with the terms of the Consent Order; b) has fully complied with the terms of the Plan; and c) 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 by mid-week.
and provided an overview of the ongoing examinations at 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, Compliance TBD – between and). 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?" 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, 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 the same examiner who had reviewed underwriting plan, as described above in Section XIII. told us that he was brought in as the EIC for the 2010 S&S Examination as a "clean set of eyes" and that tried to "shield him from Washington" during the examination. instructed to tell him if anyone from the WO interfered. Despite this, reported that reached out to him during the c2011 S&S Examination. called to tell him that the "quants" had found problems with RAL underwriting model. 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, 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.



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, 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 as follows, "as negotiations nearing completion – should know outcome within the next two weeks."

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, 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."

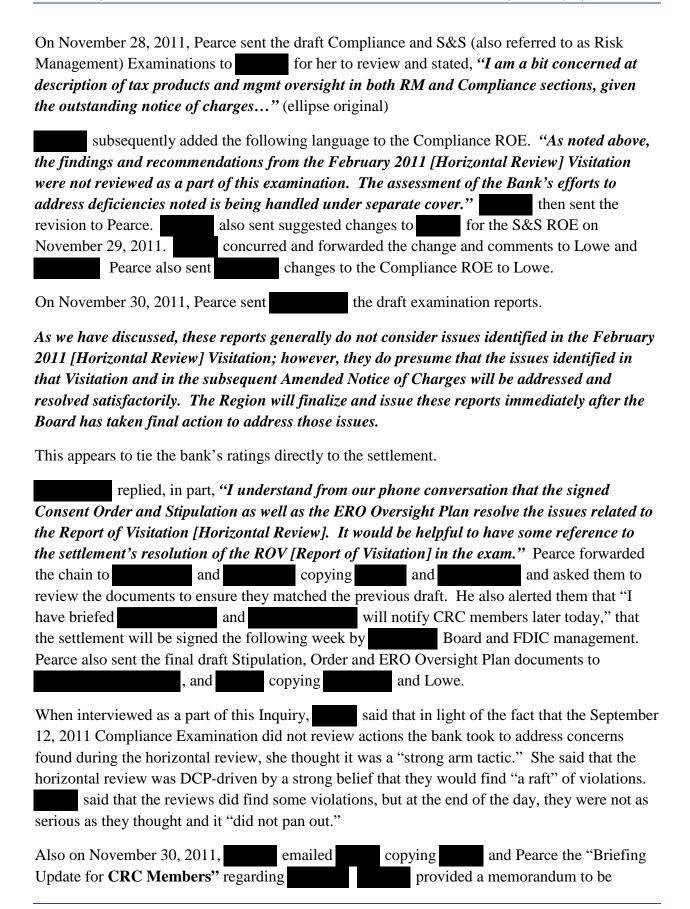
On November 26, 2011, Lowe sent Pearce the draft Compliance and S&S Examinations, both of which raised ratings to "2."

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

and I are working on the final pieces of the resolution for and I discussed a week or so ago:

- 1. will agree to exit RAL business, after next tax season
- 2. has submitted a plan for improved oversight of tax preparers...
- 3. will pay a \$900,000 CMP
- 4. FDIC agrees that _____ 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.



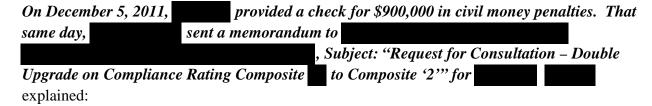
circulated to the CRC. She explained the terms of the settlement. "The Bank will exit the RAL business on or before April 30, 2012 and not resume it thereafter. The Bank will pay a CMP of \$900,000. The FDIC will terminate the Cease & Desist Order issued on February 27, 2009." She also stated that the 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 that day at 3:13 p.m. as well, alerting them of the settlement with He emailed them again at 4:53 p.m. attaching the Consent Order and Stipulation for 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:

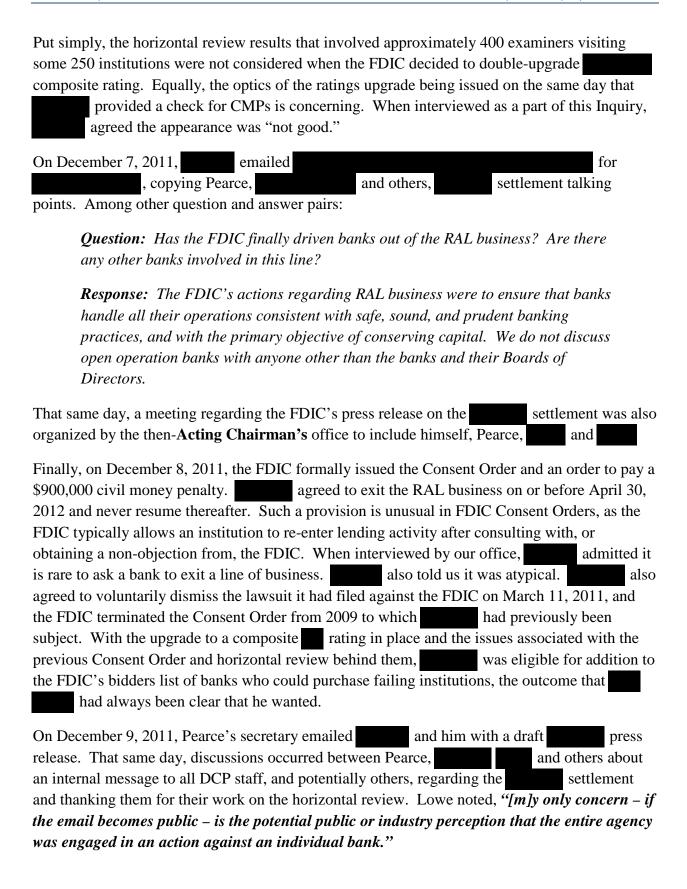
Provided that the Bank has complied with the terms of this CONSENT AGREEMENT, the FDIC agrees that it will consider any merger applications filed with the FDIC by the Bank and any requests by the Bank for clearance to bid on the assets and deposits of failing institutions. In considering such merger 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 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, Board met to discuss the settlement. 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.



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.



XXXI. Qualified Bidders List and

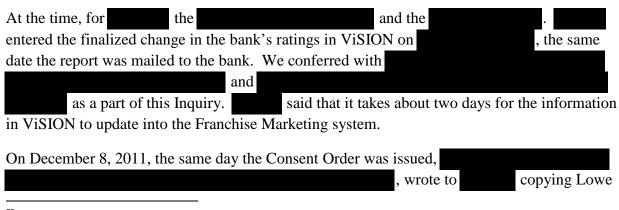
Purchase of

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

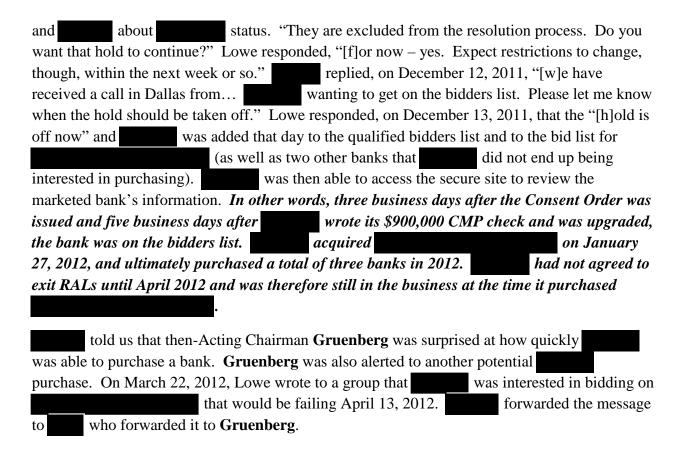
Directive Circular 6371.1 "Bidders List Preparation and Clearance Process" (December 20, 2004) explains that "DSC [now split into RMS and DCP] is responsible for pre-approving potential bidders for failing institutions and for assessing the risk to the deposit insurance fund(s) posed by potential resolution 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."



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

SENSITIVE INFORMATION - FOR OFFICIAL USE ONLY



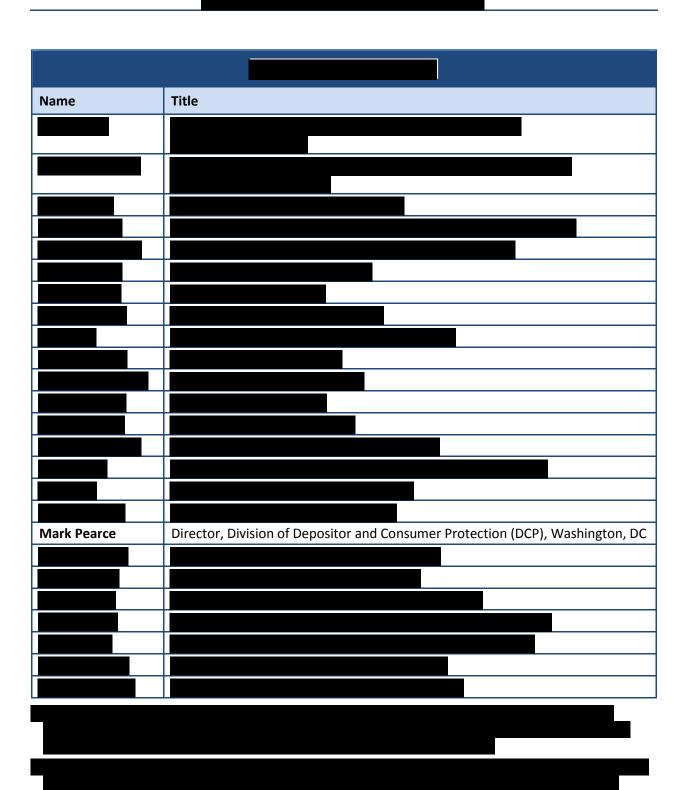
XXXII. Conclusion

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.

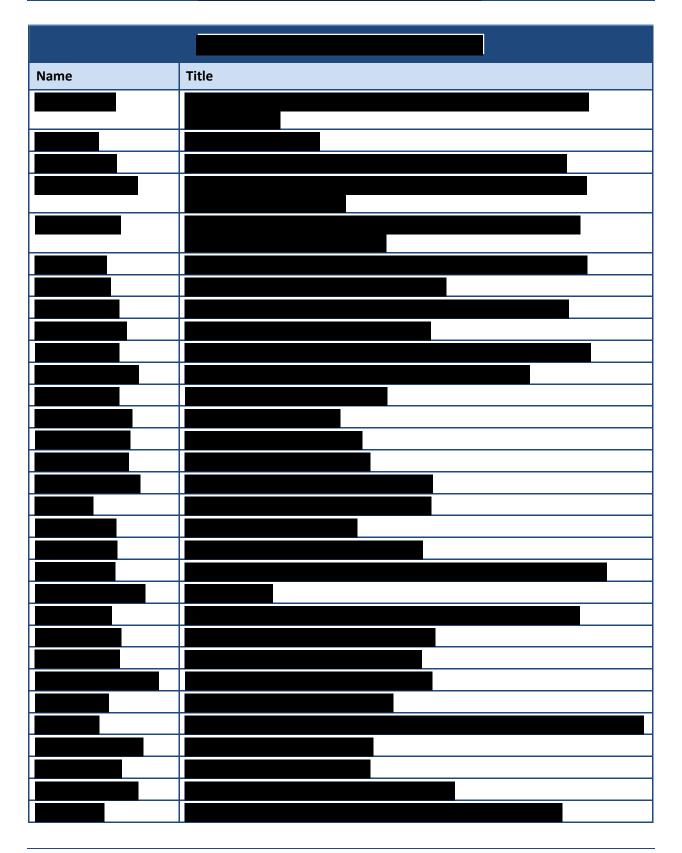
In December 2015, in response to concerns raised in the Audit, the FDIC removed the term "moral suasion" from its guidance. We appreciate the central importance of informal discussions and persuasion to the supervisory process; however, we believe more needs to be done to subject the use of moral suasion, 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

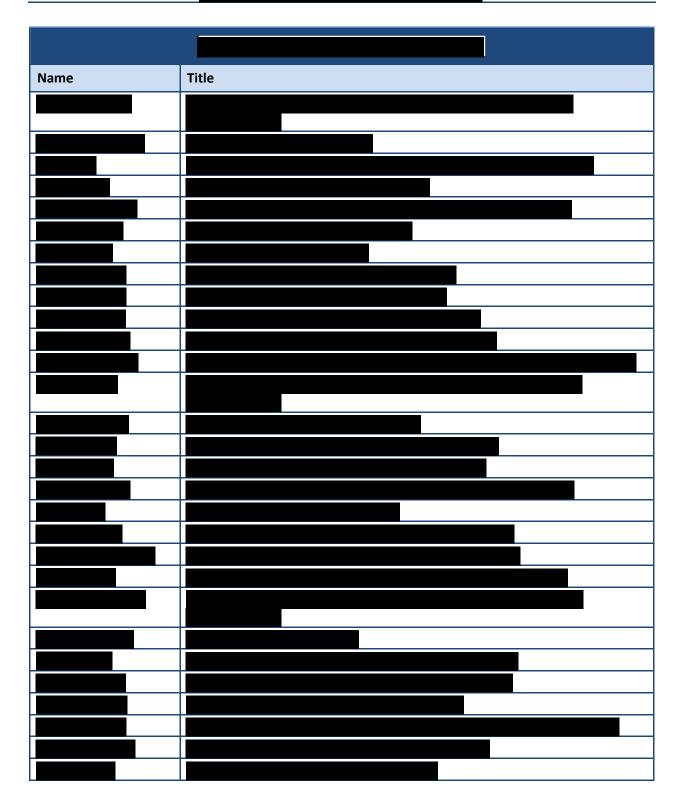
request that the FDIC report to us, 60 days from the date of our final report, on the steps it will take to address the matters raised for its consideration.



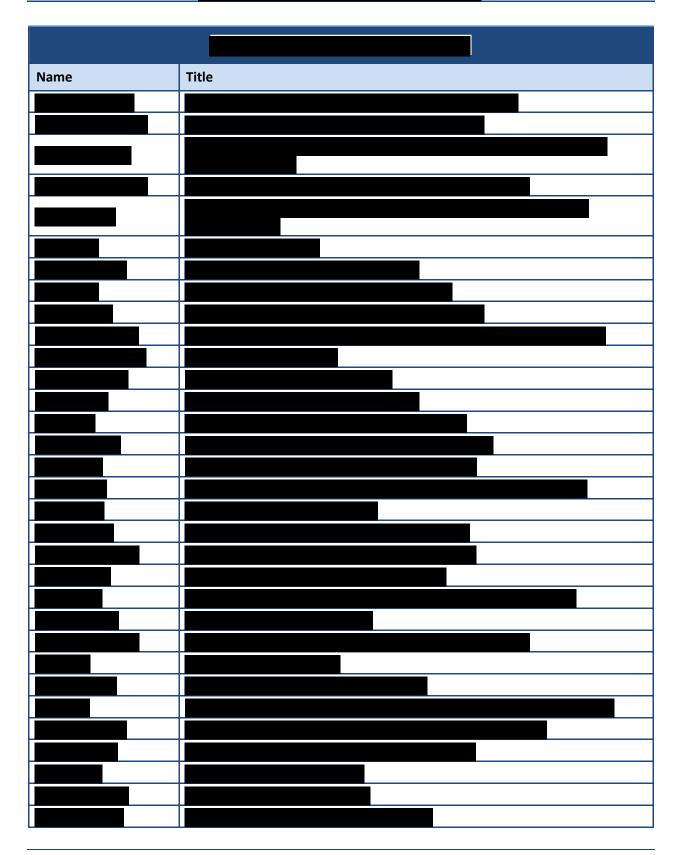




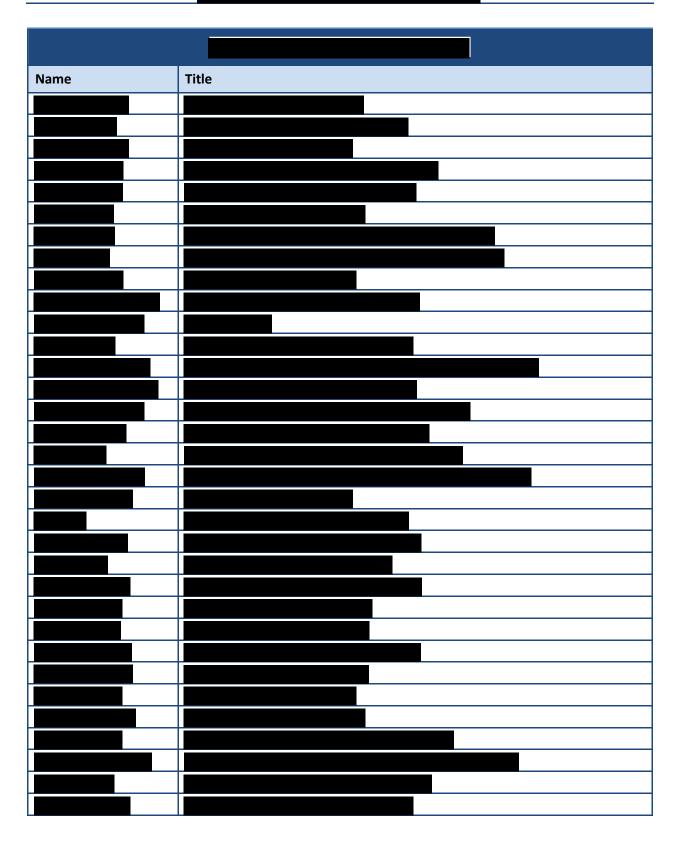




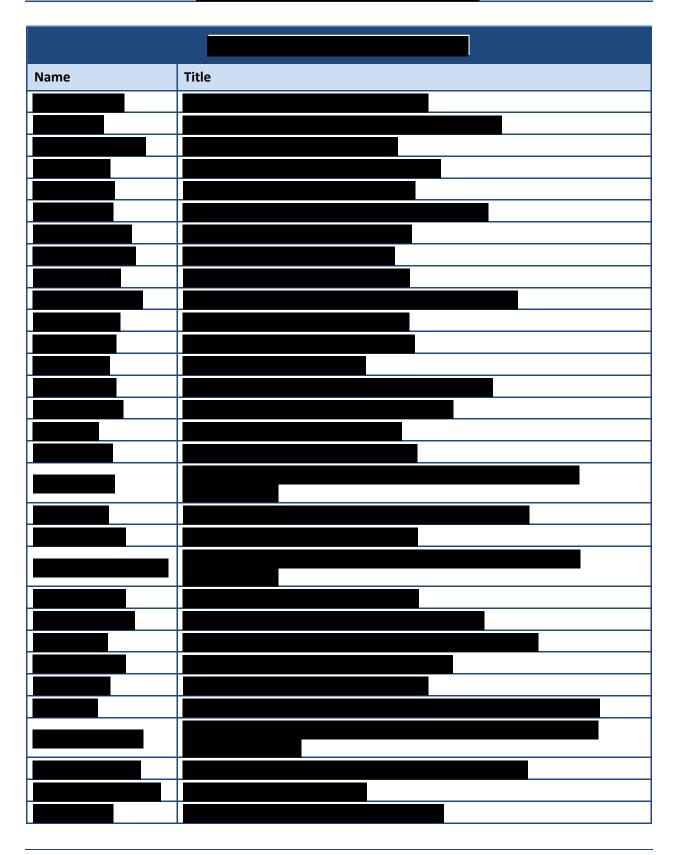


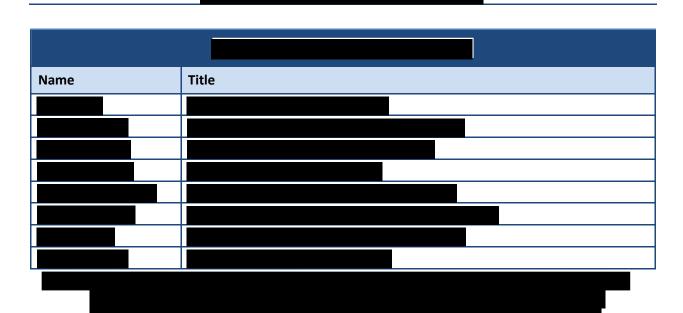














Safety and Soundness

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				

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			



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				

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			



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				

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			

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 An MOU provides a structured way to correct problems at institutions that have moderate weaknesses, but have not deteriorated to a point Understanding requiring formal corrective actions. An MOU may be appropriate if (MOU) 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	A formal written agreement is entered between a insured depository
Agreement	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 nursuant to FDI Act Section 8(a) or 8(h)

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 timeconsuming 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;
- 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.

Changes

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
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 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 is only moderately sufficient to augment capital.

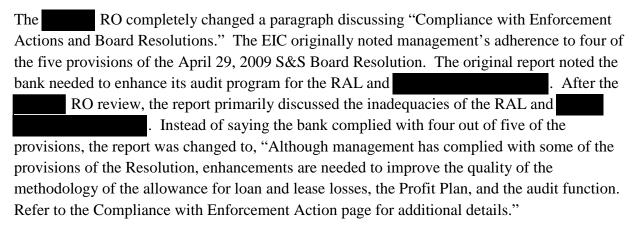
Original	After Regional Office Editing
The budget for the year 2010 projects net income	
of \$3,166M, resulting in ROAA of 1.21 percent.	
The earnings performance is on track to meet	Profit plan committee minutes indicate that the
budgeted income. Profit plan committee minutes	budget is reviewed quarterly;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



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 RO added comments describing the impact of RALs on earnings.

and Trust Changes

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

Changes to ROEs

- 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."

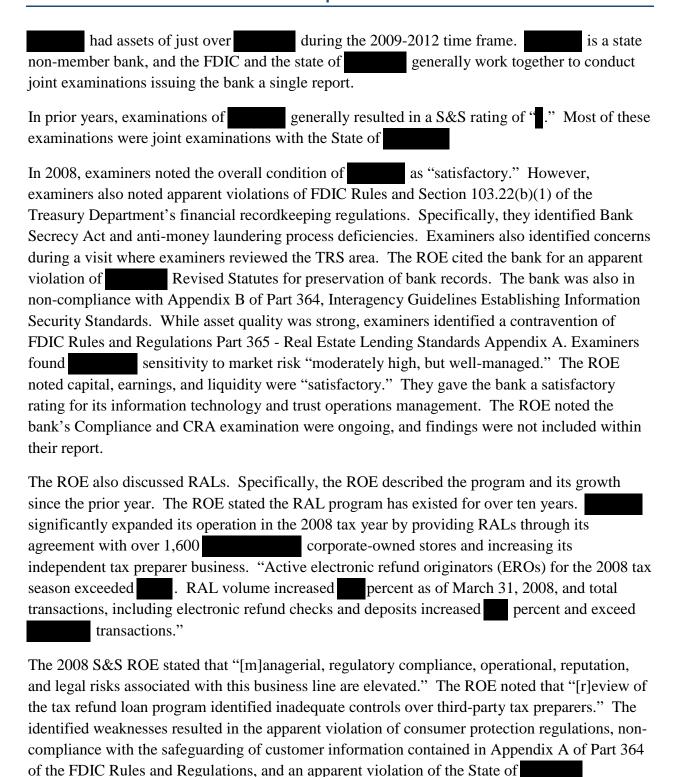
Significant Additions

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 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."



recordkeeping regulations. The ROE also identified concerns with management's slow chargeoff 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 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. May 27, 2008 Compliance Examination, the bank was downgraded from a " " to a "," 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 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 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." 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 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 capital growth. Examiners downgraded the Management component at this examination from a "" to a "." 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 as of October 19, 2009. Compliance examiners followed up on efforts to administer an effective CMS to ensure compliance with applicable consumer protection and fair lending laws and regulations. Finally, examiners evaluated performance under the CRA and determined the rating should remain as "Needs Improvement."

Again, the Compliance Examination rating of was a " ." 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 "[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, institution and subsidiary of subsequently purchased by [a federally chartered thrift], originated RALs, which were ." 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 "[1]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 compliance policies and procedures as "weak within certain areas." Compliance monitoring is also described as "weak." consumer complaint response procedures and audit function were described as "adequate."

On May 11, 2010, emailed and others, copying 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.

The February 11, 2008 S&S examination rated 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 . 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, 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.

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 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 and RALs products, including visits to ERO and Electronic Fund Initiator providers. The 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 UDAP violations for the 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 Attachments included:

- A note to file (July 15, 2010) that detailed two third-party related issues—UDAP (
) 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 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 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;
- 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.

October 21, 2010 email from Lowe to copying and others, subject:

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." The communication concluded that the need to receive additional information to resolve "the myriad of" 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.

⁹² Id

October 21, 2010 email from to Lowe, copying and subject: "Other" RAL Banks.

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

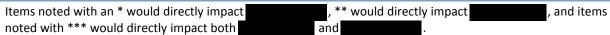
Establishes significantly higher possible penalty amounts. ***

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." ***



Changes to the Civil Money Penalty Matrix

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	4	Gain or other benefit to the institution; and/or loss or risk of	6	
2) Loss or Risk of Loss to Institution	6	loss to the institution		
History	2	History of previous supervisory actions	8	
		Algorithms 2) History of previous violations or previous deficiencies	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.

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	MOU	Memorandum of Understanding	
AGC	Associate General Counsel		National Consumer Law Center	
APA	Administrative Procedure Act	NOC	Notice of Charges	
ARM	adjustable-rate mortgage			
BSA	Bank Secrecy Act	OCC	Office of the Comptroller of the	
CAMEL	S Capital adequacy, Asset quality,		Currency	
	Management practices, Earnings	OIG	Office of Inspector General	
	performance, Liquidity position, and Sensitivity to market risk	00	Office of Ombudsman	
CEO	Chief Executive Officer			
	Consumer Federation of America	RAC	Refund Anticipation Check	
	Code of Federal Regulations	RADD	Regional Automated Document	
	Compliance Management	D.4.T	Distribution	
	Civil Money Penalty	RAL	Refund Anticipation Loan	
	Compliance Management System	DEC D		
	Community Reinvestment Act	REG B	Equal Credit Opportunity Regulation B	
	Case Review Committee		Regulation B	
CRC	Cuse Review Committee			
CSBS	Conference of State Bank Supervisors	RM	risk management	
	Division of Depositor and Consumer	RMS	Division of Risk Management	
	Protection		Supervision	
DI	Debt Indicator	RO	Regional Office	
DIR	Division of Insurance and Research	ROAA	Return on Average Assets	
DRD	Deputy Regional Director	ROE	Report of Examination	
	Division of Resolutions and	ROV	Report of Visitation	
	Receiverships	SAER	Summary Analysis of Examination	
	Division of Supervision and Consumer Protection	a. = a	Report	
	Equal Credit Opportunity Act	SARC	Supervision Appeals Review Committee	
	Examiner in Charge	S&S	Safety and Soundness	
	Electronic Refund Originator	TILA	Truth in Lending Act	
	Federal Deposit Insurance Corporation	TRAL	Tax Refund Anticipation Loan	
	Formal and Informal Action	TRS	Tax Refund Solutions	
	Procedures	UDAP	Unfair and Deceptive Acts and	
FIL	Financial Institution Letter	02111	Practices	
FOIA	Freedom of Information Act	U.S.C	United States Code	
IRS	Internal Revenue Service	ViSION	Virtual Supervisory Information	
JET	Joint Examination Team		On the Net	
		WO	Washington Office	



Division of Risk Management Supervision Legal Division

DATE:

February 17, 2016

MEMORANDUM TO:

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 report¹, 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)).
- IDIC 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 welldefined 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 RAI.
 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 time² – 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

 $^{^{2}% \}left(-\frac{1}{2}\right) =0$ 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." 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 Druft 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 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.

^a 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 amounced 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 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 INOURY 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 time⁵ 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. 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.

⁵ The employee left the agency later that same year.

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

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

Id. y td.

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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. 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. [2]

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 Louns 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 saleguard 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

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 information¹⁷ issued by the banking agencies pursuant to the Gramm-Leach-Bliley Act and the interagency guidelines establishing standards for safety and soundness¹⁸ 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 IFIEC 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.

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

¹⁴ 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/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. Additionally, legislation called for the agencies to issue guidelines establishing standards for safeguarding customer information. 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

¹⁸See https://www.fdic.gov/news/news/financial/1997/fil9744.html, Risks Associated with Subprime Lending, Mary 2, 1997; https://www.fdic.gov/news/financial/1999/FII.9920a.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, Junuary 31, 2001.
²⁰ See https://www.fdic.gov/news/financial/2001/fil0122.html, Guidelines Establishing Standards for

²⁴⁸ 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." In late 2007 or early 2008, 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 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 sup-	ervised two institutions with RAL programs	SI
	which in 2003 had	; and
	with	
At that time,	partnered with approximately 900 indo	pendent tax
preparers that were acting as EROs	to market the bank's products exclusively.	
partnered with approximately 5,600	EROs through a bank subsidiary. The FD	IC's experience
with banks offering RALs expanded	d in 2003.	

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

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which had 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, had just undertaken a rapid expansion of its program, growing the number of EROs by percent in 2001 and 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 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, 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 teanceled its contract with FBD. business was subsequently acquired by which was supervised by the Office of the Comptroller of the Currency (OCC). and 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, 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, management demonstrated a lack of understanding of its responsibility for the actions of the EROs through which it was originating credit.
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 from FDIC supervision. management was also suspected of seeking to address training deliciencies 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 unchanged from the prior exam, with a management component rating of , a downgrade from a in the prior exam. The 2009 compliance examination composite rating was , a downgrade from a , with CRA rated from a downgrade from " in the prior exam.
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February 17, 2016 Supervisory History of River City was subject to annual risk-management examinations Between 2004 and 2009, 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 an upgrade from a in the prior examination as a result of improved performance in unrelated bank activities, and the management component rating was unchanged at all. The 2009 compliance examination composite rating was a downgrade from a , with ," also a downgrade from " CRA rated " 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 . The risk management examination noted the bank had agreed to exit the RAL business. The bank was rated a for other asset quality deficiencies. Issuance of Letters to , and In July 2009, FDIC discovered that 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. ultimately shared origination documentation with FDIC, which resolved questions would demonstrate compliance with the outstanding Cease and Desist about how Order. Subsequently, was directed to advise the material changes in business plan. However, Republic did not follow that instruction when it executed contracts to expand the business with and another tax preparation notified FDIC of its assumption of this business after-thebusiness, Liberty. Rather, 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 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

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

within 60 days to discuss the future viability of the program.

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RAL activities that were being exited by large institutions would migrate to the FDIC-supervised community banks, the sent letters to sent letters to and regarding their RAL programs. The February 3, 2010, letter sent to 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 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 tentative²² 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-

²⁹ See FDIC Risk Management Manual of Examination Policies, Busic 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 and examiner disagreements were not properly documented. Notwithstanding this oversight, the report changes were appropriate, supported by the examination record, and consistent with the UFIRS.

Downgrade

The tentative ratings assigned by the examiner at the August 30, 2010 risk management examination of twee 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 twee 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

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 carnings 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

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 a 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 assigned.

Downgrade

The tentative ratings assigned by the examiner-in-charge of the October 25, 2010 risk management examination of the work to work the case manager downgraded the rating to the examiner-in-charge agreed with these changes. The final rating assigned was the which more clearly reflected the many management deficiencies and elevated risk profile of the many management and the composite ratings assigned at the October 25, 2010 risk management examination of the work 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

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

FDIC's Senior Management Properly Oversaw Policy Implementation

As the 2010 examinations of and and were concluding, DSC management discussed the region's findings, including the examination ratings, with the 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 OIG²³ 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.

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 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, had long standing deficiencies in its RAL program, and examiners had made repeated recommendations over five examinations regarding needed audit and internal control improvements. Ultimately, 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.
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. 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.

February 17, 2016 's board of directors indicated its intent to exit the RAL program in early February 2011. 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 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 DL The Office of the Comptroller of the Currency (OCC) bad similar communications with one of the banks it supervised, HSBC, about how it would underwrite RALs in a safe and sound manner responded that it would no longer offer its RAL product that relied on the absent the DI. 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 's plan to exit the RAL business on February 28, 2011. Additionally, in 2010, other large banks exited the RAL business. exited the RAL business in April 2010, citing increased regulatory scrutiny. partnered with some 13,000 independent tax preparation partners.²⁶ Further, in October 2010, that OTS was not the Office of Thrift Supervision informed to enter into any new third-party relationships concerning any credit prepared to allow product, deposit product, or ATM pursuant to OTS supervisory directives.²⁷ to originate a portion of its RAL business for the upcoming tax contracted with season. The directives essentially prohibited from making RALs. 26 See http://www.woodstockinst.org/blog/2010/consumer-advocates-cheer-chase-exits-refund-anticipation-loanbusiness, Woodstock Institute, Consumer advocates cheer as Chase exits refund anticipation loan business, Rand (2010).

Zi See http://www.mctafinancialgroup.com/Cache/10229685.pdf?IID=1027856&FID=10229685&O-3&OSID-9, 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 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 Λ ttempts 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 and and the policy and the FDIC planned to conduct unannounced horizontal reviews of the three RAL banks' EROs during the 2011 tax season. The season 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 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. The alone made loans though more than 10,000 EROs, more offices making loans than Wells Fargo has branches. 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 and and 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 scason. The horizontal review confirmed that 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 were Fully Supported

The Draft Report suggests a number of legal concerns were raised about litigation risk in the supervision of 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 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, stall engaged in vigorous and healthy debate as to whether there was sufficient legal support for the enforcement action to proceed.

had self-certified that RAL On one hand, DSC officials were aware that underwriting was not as strong without the DI and that 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 plan to address the loss of the DI by reducing available credit and increasing fees as inherently unsafe and unsound. That view refusal to consider an was coupled with concerns about asset-based lending and 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, 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 guaranter" 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. FIILBB, 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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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 with reviewing whether plan to use the LexisNexis database as a substitute for the DI was an adequate underwriting tool. After reviewing this issue³⁰, 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 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 underwriting or the particulars of the Small-Dollar Loan Pilot program in raising an issue that needed such analysis. Contrary underwriting procedures, the Small-Dollar Loan Pilot program recommended APRs no greater than percent, noted the benefits of community based lending, and did not endorse a product whose profitability was based on fees. The APR for exceeded percent --when its higher fees were treated as "finance charges" under TILA, as case law suggests they should be. 31 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.

On the other hand, certain FDIC Enforcement attorneys, including the

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. ITS 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-bypoint - in a series of memoranda - the concerns raised by the attorneys in Meanwhile, attorneys in both headquarters and 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 - 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 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, was facing potential disgorgement of at least \$24 million on the TILA claims alone. In October, 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 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 the By this point, the relationship between and the FDIC had become strained. As a result, the who was relatively new to the FDIC and had, up to that point, limited involvement with 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.

34 Each side had produced approximately 90,000 pages of documents at the time of settlement.

The memoranda were dated October 3, October, 7 and October 17, 2011 (refuting point by point concerns raised by the regarding alleged violations of TILA, ECOA, UDAP, and GLBA, as well as audit deficiencies and inadequate underwriting)...

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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 a settlement 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 and 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* gatekceper 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

bad allowed third-party vendors to transfer up to 4,300 bank accounts for Social Security recipients without the customers' knowledge or consent.

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 lindings of violations of Treasury Department regulations governing the use of the ACH payments system for processing government benefit payments through

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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 Because staff was seeking a CMP against the case was presented to the full CRC.

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

consideration of filing a Notice of Charges (Notice). On February 9, 2011, the FDIC filed its first Notice of Charges against for unsafe or unsound underwriting practices with respect to its RAL program. The Notice alleged that 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 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 yote, 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 management were consistent with FDIC policy. The Draft Report expresses concern that was allowed to qualify for the "failed bank bid list" soon after its agreement to exit

³⁷The 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").

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.

took steps to improve its oversight of EROs and documented those steps in an ERO Oversight Plan that was presented to the 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 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. 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 RALs.

The risk-management examination was mailed to 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 on December 9, 2011, and upgraded the compliance examination from 4 to 2 and the CRA rating from "Needs to Improve" to "Satisfactory." The now met the qualifications to be added to the "failed bank bid list" and it was added.

Not allowing 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 and and

Supervision History of

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 percent in 2007. Notwithstanding this increase in volume, net profit was 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 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 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 , 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

Just before the start date of the 2009 risk management examination, FDIC and OTS discovered that 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. 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 PDIC supervision or the requirements of the Cease and Desist Order, even though 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 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 Retund 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

³⁷ 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 answer, and suggested surprise visits during the next tax season in 2011.	right
The October 2009 compliance examination was lengthy, taking a little over a complete. Complications included the fact that had moved the business to it thrift for the first quarter 2009 tax season. Additionally, without providing the advance required by written direction from the FDIC, executed contracts to expand the with and another tax preparation business, with which contracted that fall. This action took place within nine days of OCC directing which funded nearly half of originations and percent of originations, to exit the RAL business, and just three days before the start of the 2010	s sister ced notice ne business initially 'Liberty's
In its letter to, OCC noted that there were significant I compliance, vendor management and reputation risks inherent in the bank's RAL bust activities. Consequently, OCC considered any RAL, activity that placed additional str capital and operations of the bank unsafe or unsound. had act business when FBD declined paystub loans in 2006. In 2006 had to charge off \$62.7 million in RAL losses due largely to high incidences fraud that ran primarily through a series of	iness ain on the quired this 07,
notified I/DIC of its assumption of this business after-the-fact on Dec 2009. Given the bank's record of risk management and compliance problems and the the bank was still operating under a C&D, I/DIC directed the bank, in writing, to submitthin 15 days to exit the RALs business within 60 days. A second letter was issued day to instead require that a meeting be scheduled within 60 days to discuss the future of the program. These events were clearly laid out in the 2009 compliance report of examination.	fact that ait a plan the next
On March 10, 2010, while the compliance examination was ongoing, the advised the bank's Board by letter that preliminary examination fin identified significant ongoing concerns regarding the bank's ability to appropriately a measure, monitor and control third-party risk. More specifically, the stated that the concern centered on the bank's continued expansion of third-party relative to its non-traditional business lines while operating under an outstanding C&I expressly requires controlling such third-party risk. The that although material weaknesses had been identified internally by the bank's audit p the Board and management made a business decision to continue to expand the RAL Continued growth, during a period when the bank was operating under a C&D and on	donships D, which bserved rograms, program.
48 Katie Kuehner-Hehert, In Brief: Cites Tax Loan Problems, American Banker, Apr. 2	5, 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 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

As with FBD and the 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 s RAL program. The January 2007 State of 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 Management component rating and upgraded the composite rating to 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 cheeks issued by 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 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 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-olls) were 48.9 percent of RAL related income up to that point in 2008 and 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 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 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 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 and a CRA rating of Needs to Improve. With respect to the downgrade of the compliance rating, the examiner stated, "[I]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 yendors will be visited."

Supervision Relative to

entered into the RAL business in 2007. During 2007, the State of 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 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 . The risk management examination noted the bank would no longer participate in the RAL program after this year. The bank was rated a for other asset quality deficiencies.

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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 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 and and y, examiner disagreements were not properly documented. Nonetheless, the changes were appropriate, supported by the examination record, and consistent with the UFIRS.

Downgrade

The tentative ratings assigned by the examiner at the August 30, 2010 risk management examination of were During the regional office review process, the rating was downgraded to The final Management, Earnings and Liquidity component and the composite ratings assigned at the August 30, 2010 risk management examination of 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 versus

The UFIRS defines the Management component ratings of and as follows:

"A Management rating of 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."

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 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 ...

- 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 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 and 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 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 carnings, capital accretion and loan quality.

Earnings Component Rating of versus

The UFIRS defines the Earnings component ratings of and as follows:

"A rating of 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 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. Farnings 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."

Farnings strength is measured not only by the quantity and trend of carnings 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 carnings are more accurately characterized as satisfactory rather than strong, supporting an Earnings component rating of \blacksquare .

The examination report noted the IRS would not be providing the Debt Indicator to RAI. 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.

Liquidity Component Rating of versus

The UFIRS defines the Liquidity component ratings of and as follows:

"A rating of 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 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 rating assigned.

- The report of examination described reliance on noncore funding as elevated as
 evidenced by the net noncore dependency ratio of 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 and as follows:

"Financial institutions in this group for 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 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 for 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 rating assigned.

 exhibited a degree of supervisory concern in the Management component area as evidenced by the Management component rating continued from the prior examination.

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- 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 transfer of the 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.

Downgrade

The tentative ratings assigned by the examiner-in-charge of the October 25, 2010 risk management examination of the were the work. During the regional office review process, the case manager downgraded the rating to the examiner-in-charge agreed with these changes. The final rating assigned was the Composite ratings assigned at the October 25, 2010 risk management component and the composite ratings assigned 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.

Management Component Rating of versus

The UFIRS defines the Management component ratings of and as follows:

"A rating of 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 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 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

- 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 auditrelated contravention had been cited relative to the RAL program. The examiner-incharge 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 another time in
- 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 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 program. Lax 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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Composite Rating of versus

The UFIRS defines the Composite ratings of and as follows:

"Financial institutions in this group for 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 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 for 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

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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.