Chairman Hensarling, Ranking Member Waters, and Members of the Committee on Financial Services:

Thank you for the opportunity to submit a written statement regarding the hearing entitled “The FDIC’s Targeting of Refund Anticipation Loans.” The National Consumer Law Center (NCLC) has considerable expertise and interest on the issue of refund anticipation loans (RALs), refund anticipation checks (RACs), other tax-time financial products, and taxpayer consumer protection. We offer our testimony here on behalf of our low-income clients, as well as the Consumer Federation of America.

We believe the FDIC had good reason to be concerned about the RALs offered by its supervisee banks, and should continue to closely supervise these same banks regarding their current tax refund-related offerings. The FDIC’s actions during the 2011 to 2012 time period were measured, appropriate, and necessary to protect both consumers and the safety and soundness of banks. In particular:

- RALs made by FDIC-supervised banks and other banks subjected taxpayers to triple-digit interest rates, skimmed billions from their refunds, and put them at risk of unmanageable debt. The FDIC protected taxpayers by stopping RAL abuses.

- RALs presented a significant risk to the safety and soundness of banks, because of the massive levels of errors and fraud from paid tax preparers that still continue to this day. The FDIC was entirely justified in getting its supervisee banks to stop making these loans

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1 Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

2 NCLC and the Consumer Federation of America have jointly authored annual reports on RALs, RACs and tax-time financial products since 2002. NCLC has also authored a number of other reports on tax-time consumer issues. The annual RAL reports and other tax-consumer issue reports are available at www.nclc.org/issues/taxes.html.

3 The Consumer Federation of America is an association of more than 250 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education. www.consumerfed.org

- The need for FDIC oversight of RAL lending banks and tax preparers continues to this day. This year, FDIC-supervised banks are offering RALs that are allegedly “no fee” to the consumer, but present a risk of consumer abuse. Refund anticipation checks represent a disguised loan of the tax preparation fee, with triple digit annual percentage rates (APRs).

FDIC Actions Stopped RAL Abuse of Taxpayers

From about the mid-1990s until 2012, a handful of banks (including three FDIC-supervised banks) made tens of millions of RALs that drained billions of dollars from the refunds of hard-working taxpayers. These RALs were one- to two-week loans made by banks and offered by tax preparers, without underwriting for ability to pay and secured by the taxpayer’s refund.4 These RALs were extremely expensive: with fees from $30 to nearly $140, the APRs for RALs ranged from 50% to 500%. RALs also collectively drained billions from taxpayer refunds. From 2002 to 2012, RALs collectively skimmed over $9.6 billion from the refunds of tens of million American taxpayers.5

RALs targeted low-income taxpayers, especially recipients of the Earned Income Tax Credit (EITC). In 2010, over 90% of taxpayers who applied for a RAL were low-income, and nearly two-thirds (66%) were EITC recipients. Yet EITC recipients made up only 20% of individual taxpayers in that year.

RALs also presented significant financial risks to taxpayers. If a refund is denied because of a preparer’s error or for any other reasons, the taxpayer would end up on the hook for the loan. This imposed a substantial hardship, because the taxpayer usually had not budgeted to repay this loan. The taxpayer might be subjected to debt collection harassment, a damaged credit rating, or even have next year’s refund grabbed to pay off the loan.

RALs Pose a Safety & Soundness to Banks

The harms of RALs are not limited to their impact on consumers. RALs present significant safety and soundness risks because the high levels of fraud and errors by tax preparers, who act as bank agents when they offer a RAL. In fact, concerns over RALs and tax fraud were

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4 A product related to RALs is the refund anticipation check (RAC). With RACs, the bank opens a temporary bank account into which the IRS direct deposits the refund check. After the refund is deposited, the bank issues the consumer a check, direct deposit or prepaid card with the refund proceeds minus the RAC fee, tax preparation fee, and any add on junk fees. The bank then closes the temporary account.

5 The data in this section is derived from the annual reports of the National Consumer Law Center and Consumer Federation of America on RALs, RACs, and other tax-time consumer issues. These reports are all available at www.nclc.org/issues/taxes.html#ral.
significant enough for the Internal Revenue Service (IRS) to open a rulemaking proceeding regarding the issue in 2008.6

A startling fact about the tax preparation industry is that, in all but four states, paid tax preparers are not required to meet any minimum educational, competency, or training standards. The lack of competency standards has allowed errors and fraud by tax preparers to flourish. As the chart below shows, mystery shopper tests of tax preparers by the Government Accountability Office, the Treasury Inspector General for Tax Administration, and consumer groups have found high levels of errors, fraud and other abuses.7 Fraud has a direct impact on the safety and soundness of RALs, because the accuracy of the tax return is critical in determining whether the loan should be made, whether it will be repaid, and whether a subsequent IRS audit could result in problems for the bank.

Law enforcement actions have similarly uncovered massive fraud schemes, including the U.S. Department of Justice (USDOJ) action in April 2007 against five Jackson Hewitt franchisees that falsely claiming $70 million in tax refunds.8

6 73 Fed. Reg. 1131 (Jan. 7, 2008)(asking whether IRS should develop rules restricting the sharing of tax return information to market RALs, RACs, and other financial products). For more on how RALs promote tax fraud, see Chi Chi Wu, National Consumer Law Center, RALs, Tax Fraud, and Fringe Preparers (Feb. 2009).
7 This chart is based on the rounds of mystery shopper testing discussed in Chi Chi Wu, National Consumer Law Center, Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do (November 2013), available at www.nclc.org/issues/riddled-returns.html.
In addition to errors and fraud, the role of the tax preparer in making RALs was critical because they acted as the bank’s agent when making a RAL. Tax preparers solicited customers for the loans, explained (or failed to explain) the loan terms to consumers, processed loan documentation, obtained the consumer’s signature, retained the loan documents on file, and even printed RAL checks. They determined the size of the loan and purported to ensure its soundness, through their work in preparing the tax return. In short, tax preparers did everything but make the ultimate approval decision and fund the loan. Given that these preparers were not -- and still are not -- supervised by anyone else, it was appropriate and necessary for the FDIC to examine them, including when the FDIC conducted visitations of 250 tax preparers that offered RALs made by Republic Bank & Trust. These visitations were critically important because they found that Republic had failed to properly train and monitor its tax preparers, resulting in multiple legal violations including:9

- **Truth-in-Lending Act (TILA)** - The FDIC found that copies of the written disclosures required by TILA were regularly absent from loan files. In addition, nearly 88% of the tax preparers that FDIC investigators called failed to make an oral disclosure of the annual percentage rate (APR) when requested.
- **Gramm-Leach-Bliley Act** - Tax preparers did not have proper physical and electronic safeguards for the protection of confidential consumer information, such as shredders or locked dumpsters. Half of the tax preparer offices had no alarm system, even though the stores had bank checks inside.
- **Federal Trade Commission Act** - The FDIC alleged that Republic engaged in unfair and deceptive actions, such as implying that customers would receive the full amount of their refunds minus fees in one or two days by getting a RAL, despite the fact that the RAL amounts were limited by Republic to $1,500.
- **Equal Credit Opportunity Act (ECOA)** - The FDIC found tax preparers refused to process a RAL application when only one spouse applied for the loan, in violation of the ECOA.

Nearly half (46.5 percent) of tax preparers who made Republic RALs were in violation of at least three different laws. The FDIC found that Republic failed to properly train tax preparers to comply with consumer protection laws. In particular, Republic tested preparers’ knowledge of consumer laws by giving them an online quiz that permitted the preparers to keep guessing until they passed the test. In addition, the FDIC alleged that Republic attempted to interfere with its investigation by setting up an Internet webpage of Frequently Asked Questions to coach tax preparers during the day when the FDIC tested the preparers.

The high levels of errors and fraud, combined with these multiple legal violations, by themselves would have justified the FDIC’s actions in 2011 and 2012 to encourage its supervisee banks to stop making RALs. However, there was an additional critical factor. The FDIC’s actions were

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also based upon the termination of the Debt Indicator by the IRS in August 2010. The Debt Indicator was an IRS-provided service that helped tax preparers and banks make RALs by notifying them if the borrower’s refund would be intercepted by the government for certain debts. Without the Debt Indicator, a RAL could go unpaid, harming both the bank and the taxpayer. It was entirely appropriate for the FDIC to warn its banks of the safety and soundness risks of making RALs without the Debt Indicator.

It is also important to note that the FDIC was not alone in prompting its supervisee banks to leave the RAL market. The Office of Comptroller of Currency (OCC) had forced two of its banks (Pacific Capital Bancorp and HSBC) to stop making RALs. The OCC’s actions were actually stronger, in that it issued regulatory directives prohibiting those two banks from making RALs.

Need For Vigorous FDIC Supervision of RAL Lending Continues to Today

The FDIC’s close supervision of RAL lending banks was not only appropriate back in 2011 and 2012, it needs to continue. There is a new generation of RALs -- “advances” that supposedly do not impose a charge on the consumer for the loan. Two of the lenders for these “no fee” RALs are FDIC supervised banks – Republic Bank & Trust and River City Bank.

These “no-fee” RALs could present risks to consumers. Even though there is supposedly no charge to the consumer, Republic Bank & Trust charges the tax preparer a $35 fee for its “no fee” RAL. Preparers might pass along this fee, or charge even more, by padding their tax preparation fees or by charging separate “add-on” junk fees. Tax preparation fees are extremely non-transparent, and can be high. Few consumers can get a firm price estimate before having their refund prepared, so hidden fees can be hard to avoid. Because it can conduct examinations, the FDIC is perhaps the only entity that could detect if preparers are passing along the $35 fee to consumers without their knowledge.

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River City Bank offers a “no-fee” RAL but does not charge the tax preparer. However, if a taxpayer obtains a refund anticipation check, she will pay more. River City offers several RAC programs. If a preparer offers “no fee” RALs, then River City will charge the taxpayer $39.95 for the RAC. But if a tax preparer does not offer the “no-fee” RAL, it has the option of offering RACs for a lower fee, either $29.95 or $34.95. This price difference could be a hidden finance charge for this supposedly “no-fee” RAL.15

It is also important to note that the FDIC must continue to closely monitor RAL lending because the fraud and error issues continue as well. Last year, mystery shopper testing by consumer advocacy groups in Florida and North Carolina found inaccuracies in 27 out of the 29 tax returns prepared by paid tax preparers.16 And just last month, the USDOJ filed an enforcement action seeking to bar a Liberty Tax Service franchise in South Carolina from preparing tax returns, alleging that the franchise deliberately prepared fraudulent returns and inflated federal tax refunds by giving taxpayers income from fictional jobs and claiming children that didn’t exist.17

Finally, the FDIC needs to continue to examine banks like Republic Bank and River City Bank when they offer refund anticipation checks (RACs). While the banks claim otherwise, RACs increasingly represent nothing more than a disguised loan of the tax preparation fee. When taxpayers obtain a RAC simply because they cannot afford the price of tax preparation upfront, they are essentially paying to defer payment of the tax preparation fee—which is a loan. If a taxpayer pays $35 to defer payment of a $350 tax preparation fee for three weeks, the APR would be equivalent to 174%. At least two court decisions have held that a RAC constitutes a loan of the tax preparation fee, and thus RAC fees are finance charges under the Truth in Lending Act.18

Conclusion

The FDIC did the right thing in 2011-2012 by prompting its supervisee banks to stop making RALs. Its actions were justified, and it should continue to closely supervise these same banks regarding their current tax refund-related offerings.

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