Consumer Groups Urge Bank Regulators to Address Refund Anticipation Loans

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Greetings,

As you know, the Internal Revenue Service announced in August that it would it cease providing the Debt Indicator, an IRS-provided credit check that allowed banks making refund anticipation loans (RAL) to determine if RAL borrowers had any pending offsets against their tax refund for debts owed to the government. With the end of the Debt Indicator, we respectfully request that the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency take the next step necessary to ensure RALs are not made in an unsafe and unsound fashion that harm borrowers, lenders and the integrity of the banking and tax system. We applaud the actions of the Office of Thrift Supervision to end MetaBank's refund anticipation lending and other practices deemed inconsistent with regulatory compliance.

Consumer advocates applauded the end of the Debt Indicator, as the IRS should not be aiding and abetting RALs using taxpayer dollars, and sharing taxpayers' private information for the profit of high cost lenders. However, the IRS elimination of the Debt Indicator has not ended RAL lending, and thus the banking regulators must act to prevent improvident loans from being made in the upcoming tax season. We respectfully request that the FDIC and OCC either order the institutions under their supervision to cease making RALs, or at a minimum, to require that they underwrite RALs based on the borrower's ability to pay *without consideration of the anticipated tax refund.*

Tax preparers and their bank partners have publicly confirmed they will continue to make RALs - H&R Block with HSBC, Jackson Hewitt//Liberty Tax Services with Republic Bank, Intuit and Ohio River Valley, River City Bank with independent tax preparers. These companies have stated they will raise the fees for RALs to offset anticipated greater losses.

Without a requirement that RAL lenders consider the ability to pay, the result will a potential worst case scenario where consumers pay more for RALs, a significant number default when refunds are offset, and lenders suffer high losses. Consumers who are provided a loan that cannot be repaid from their tax refund will owe on a defaulted loan, potentially subjecting them to debt collection and harm to their credit histories. The majority of RAL borrowers are low income recipients of the EITC and do not have the means to repay RALs out of their everyday incomes. These lenders are willing to take on massive losses, and to ensure a profit in the face of such losses, by charging usurious rates to lend taxpayers their own money, which the taxpayers would receive without a loan in as little as 10 days. There is a need for bank regulatory action to ensure safe lending.

According to a 2005 IRS study, approximately 8.8% of Debt Indicator inquiries show a pending tax offset. This is a conservative estimate, as we have been told that 10% to 15% of RAL applications are denied, presumably the bulk of them on the basis of the Debt Indicator. Thus, RAL lenders are willing to accept loan losses of at least 8% - far higher than loan losses for other types of lending, such as credit cards or even payday loans – and make up for such losses by charging triple digit APRs.

According to the most recent study by the National Consumer Law Center and Consumer Federation of America, in 2008, there were 8.4 million RALs, with a typical average refund of $3,300. Using these numbers as a baseline, 8.8% of 8.4 million RALs could affect 738,000 borrowers who have tax offsets reducing their tax refund. This could create hundreds of millions of bad debt ranging from several hundred to several thousand for borrowers. This is not good for lenders, borrowers or the system as a whole.

The banking regulators should take action earlier than later to address this problem. The FDIC and the OCC should require their supervised banks to underwrite RALs by a borrower's ability to repay according to income, assets and credit worthiness – *without consideration of the borrower's tax refund*. As we all know from the recent mortgage crisis, collateral-based lending is extremely risky and destructive, resulting in harm to both lenders and borrowers. Without the Debt Indicator, the regulators cannot permit RALS to be underwritten by only the anticipated tax refund.

Lenders who insist on making RALS should also have an installment loan product available for borrowers to pay off the RAL if the tax refund is not paid. This is a basic issue of safety and soundness in underwriting. Losses are bad for lenders and borrowers. Ability to repay should be the touchstone for all lending. Indeed, Congress expressed that very principle in the recently enacted Credit Card Accountability, Responsibility and Disclosures Act by requiring an ability to pay analysis for credit card lending. The FDIC and the OCC should do the same for RAL lending

We urge regulators to address this problem substantively prior to the 2011 tax season as preparers and lenders begin marketing pre-file loan products as early as Thanksgiving.

Sincerely,

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cc: John Bowman
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