SNL Financial

THE REGULATOR

Friday, March 05, 2010 10:25 AM ET Exclusive

Predatory Lending and Meaningless Guidance

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On Feb. 18, the OCC released a "consumer advisory and policy statement" on refund anticipation loans (RALs), warning the public that these financial products can be predatory and dangerous. The agency's press release makes it sound as if the OCC is actually doing something to protect consumers, but if you look closely at the action, it's clear that the OCC is actually promising banks—and two big banks in particular—that it will not regulate these products.

Nothing in the policy statement or the consumer advisory actually requires banks to do anything of substance. There is no cap on interest rates, no cap on RAL portfolio size, and most importantly, no mandated penalty for any bank that fails to live up to the standards the OCC suggests.

There are good reasons for bank regulators to be worried about RALs. These "loans" are a clever financial trick that allows banks and tax preparers to skim from consumer tax rebates. A tax preparation service like H&R Block does a consumer's income taxes, and writes him an immediate check. This cash is technically a loan that is being extended by a third-party bank. When the consumer's tax rebate comes in one-to-two weeks later, the bank pockets the check. The trick, of course, is that the actual tax rebate is larger than the check the tax preparer gave the consumer. The difference between the two is the "interest" on the loan.

It's conceivable that RALs could actually be useful to some consumers in some circumstances, given a reasonable interest rate. It's also easy to imagine scuzzy tax preparers taking advantage of consumers, taking their money without telling them what's going on. A recent report from the National Consumer Law Center indicates that the standard fees on RALs start at about $65, and include a host of other lender-added fees like a "technology access fee" (a JPMorgan Chase specialty) and other fees added by the tax preparer that can more than double the cost of this loan. Depending on the size of the tax refund, typical RALs can carry an APR well over 200%, since the term of the loan is so short. That kind of interest rate is neither reasonable nor necessary for most taxpayers. If they understood what was going on, most RAL customers probably wouldn't be going to a tax preparer to begin with, where they pay an additional $175 - $290 for something they can do by themselves for free online. Taken together, RAL and tax preparation costs can hit consumers for up to $400 per return.

The RAL industry specifically targets the poor, people for whom $400 is a serious money. A full 63% of the people who received RALs in 2008 were receiving the Earned Income Tax Credit—the largest anti-poverty program in the United States, according to NCLC calculations based on IRS data (6.2 million EITC tax returns involved a RAL, and NCLC calculates that approximately 85% of RAL applications are ultimately approved, bringing the figure to 5.3 million, out of 8.4 million total RALs). By comparison, just 16% of taxpayers actually receive the poverty tax credit. RALs target the poor, making taxpayer-funded efforts to fight poverty less effective and more expensive in the process. Banks are not responsible for the entire mess, but their decision to take part in such a predatory business is truly odious.

And the tiny number of RAL lenders makes the OCC's RAL "guidance" utterly preposterous. In 2009, the entire industry—which brought in over $730 million, according to the NCLC—essentially consisted of just four banks: HSBC Holdings plc, JPMorgan Chase, Louisville, Ky.-based Republic Bank & Trust Co. and Pacific Capital Bancorp. The OCC has oversight over all but Republic, which is regulated by the FDIC. If any regulators wanted to go after the RAL industry, they could go into these four banks and tell them to stop making RALs, charge less for them or crack down on deceptive marketing. In short, they could actually regulate the banks.

That's exactly what the FDIC did in February 2009, hitting Republic with a formal cease and desist order telling the bank to clean up its mess. The agency is now rumored to be readying a ban on RALs at all state-chartered banks, perhaps as early as this tax season.

So why does the OCC bother to issue a vague statement saying that RALs might be bad if some banks aren't careful? The OCC is covering its tail. The agency sees that certain banks are making a lot of money on products that are often egregiously predatory and deceptive. Consumer advocates and other regulators are raising a fuss, and even the IRS now plans to regulate tax preparation services. The OCC wants to be able to say it did something when people look back and start pointing fingers at the corrupt officials who allowed this hoodwinking to continue unabated for so long. But the OCC is also completely captured by the banking industry, particularly the largest banks. It doesn't want to do anything that might upset bankers, or worse yet, cost banks some money. So instead of issuing a real, formal regulation that banks would have to follow under penalty of law, the OCC is politely suggesting that banks alter their behavior. The irony, of course, is that banks know these suggestions will not and cannot be enforced. By issuing these non-regulations, the OCC is actually promising not to lift a finger over the RAL businesses run by HSBC and JPMorgan Chase.

"The OCC's widespread use of 'supervisory guidance' and other precatory, non-binding statements has been carefully designed to provide the agency with plausible deniability for its real policy of avoiding the issuance of any binding rules that would protect consumers against predatory behavior by national banks and their operating subsidiaries," George Washington University Law School Professor Arthur Wilmarth Jr. told SNL.

Regulators resort to this gimmickry all the time. In 2006, the OCC issued "guidance" on nontraditional mortgages which both banks and the OCC itself essentially ignored. The problem is not limited to consumer protection regulation. In 2006, the OCC and other bank regulators issued "guidance" on commercial real estate exposure that proved utterly useless, as the banking industry's current CRE woes attest.

The OCC declined to comment for this story. HSBC spokesman Rob Sherman told SNL that his company "has exited the RAL business, with the exception of an ongoing arrangement with H&R Block, with whom we have a contractual obligation." H&R Block is the largest tax preparer in the U.S., and issued 3.9 million RALs in 2008. JPMorgan Chase spokesman Greg Hassell told SNL that his company provides RALs to people, "who want access to cash sooner and are willing to pay a reasonable fee to do so." Hassell added, "Our fees are clearly disclosed: $32 plus 1 percent of the loan amount." He did not mention Chase's additional $10 technology access fee.

Once upon a time, when regulators saw a serious problem in the banking system, they had to actually do something about it. But in 1994, Congress passed the Riegle Community Development and Regulatory Improvement Act. Though not as famous as its companion bill, the Riegle-Neal Interstate Banking and Efficiency Act, this other Riegle bill permitted regulators to issue nonbinding guidance instead of formal, enforceable rules.

At the time, the banking industry was enlisting the law firm of Covington & Burling to help push its legislative agenda through Congress. The top bank lobbyist at Covington & Burling was John Dugan, the current Comptroller of the Currency.

Dugan's record on consumer protection and financial regulation is beyond repair, but there is a way for the OCC to save some face on the RAL scandal. In April 2009, consumer groups pressed the agency hard to go after RAL banks, particularly Pacific Capital, and impose the same restrictions the FDIC placed on Republic Bank and Trust. The OCC initially rebuffed their requests, but in June 2009, the state of California won a major lawsuit against Liberty Tax Service (you may have seen the mascots Liberty hires to dance around in the streets wearing big foam costumes). It turns out Liberty did not disclose that the immediate tax "refunds" it was offering customers were actually loans through Pacific Capital, violating multiple federal laws.

So on Dec. 18, 2009, after several missed TARP dividend payments and with Pacific Capital's stock trading at $1.29, the OCC finally came down on the company, refusing to approve its RAL program for 2010, and leading Pacific Capital to sell the RAL division to raise capital.

The OCC needs to take similar action on HSBC and JPMorgan, both of which issue millions of RALs every year. Instead, the agency is deploying the same tools it used to no avail against predatory mortgage lending and commercial real estate exposure.