National Consumer Law Center
Consumer Federation of America
AARP
California Reinvestment Coalition
Community Reinvestment Ass'n of NC
Consumer Action
Consumers Union
National Association of Consumer Advocates
Neighborhood Economic Development Advocacy Project
U.S. Public Interest Research Group
Woodstock Institute

December 18, 2006

By Fax (202-874-4950) and First Class Mail
The Honorable John C. Dugan
Comptroller
Office of the Comptroller of the Currency
250 E Street, NW
Washington, DC 20219-0001

Dear Comptroller Dugan:

The undersigned groups request that your office take action to require national banks to cease making "pay stub" and "holiday" refund anticipation loans (RALs). These RALs are made by tax preparers and banks prior to the tax filing season and before taxpayers have received their IRS Form W-2s. Since a taxpayer cannot file a tax return without a W-2, pay stub RALs are made based upon an estimated tax refund calculated from the consumer's most recent pay stub, hence the name. Pay stub RALs are made in early to mid January, while holiday RALs are made even earlier, during November and December. Both types of loans are expected to be repaid from the proceeds of the borrower's tax refund, not from current income.

The National Consumer Law Center and Consumer Federation of America released a report last month documenting the various problems and abuses from pay stub and holiday RALs. A copy of the report is attached, and we are sending by mail copies of pay stub RAL and holiday RAL loan documents. Some of the key points of the NCLC/CFA report are:

- National banks that make both pay stub and holiday RALs include Santa Barbara Bank & Trust and HSBC. JPMorgan Chase will be making pay stub RALs, but not holiday RALs.
- Pay stub RAL fees can be as high as $102, translating into triple digit APRs, plus at least one tax preparation chain charges a $50 "deposit" for tax preparation

services when making the loan. These fees add to the $1.24 billion drain posed by RALs on taxpayer's refunds and EITC benefits.

- Pay stub RALs pose significant risks to taxpayers, because they are made based on estimated tax returns before taxpayers receive their final tax information from a W-2. At the time that the pay stub RAL is made, for example, the tax preparer would not have any information if the IRS is planning to seize all or part of the taxpayer's refund to pay a child support or student loan debt. The taxpayer may have pre-tax deductions such as retirement contributions that are not accurately reflected on the taxpayer's final pay stub. A taxpayer might have other sources of income not reflected on his pay stub that reduce his refund, such as a second job, income from a 1099, or unemployment compensation.
- Pay stub and holiday RALs are also risky to lenders, both on safety and soundness and reputational risk grounds. Without a W-2, a taxpayer might be able to obtain more than one loan from different lenders. A taxpayer could also get a pay stub RAL, then subsequently file directly with the IRS. An identity thief could make up a pay stub using commonly available software and a stolen Social Security Number from a consumer with a good credit history.
- At least one tax preparer appears to be forcing pay stub RAL borrowers to return to the same preparer to have their taxes prepared, preventing these taxpayers from seeking out less expensive alternatives, such as IRS Free File, a free tax preparation program or even a cheaper competitor.
- Several legal issues are created by the fact that a pay stub RAL is due either the earlier of mid-February or when the taxpayer returns and gets a traditional RAL or refund anticipation check product. First, the APR disclosure can vary widely because the loan period could be as little as a few days to over a month and a half or more. Second, there is an issue of whether any of the finance charge is required to be rebated under the federal rebate statute, 15 U.S.C. § 1615, if the loan is repaid prior to the mid-February due date. Finally, if the taxpayer does not return to Jackson Hewitt, the $50 deposit charged for tax preparation is never refunded to the taxpayer and could be considered a finance charge under the Truth in Lending Act.
- Pay stub and holiday RALs also pose a problem because they enable the RAL industry to keep draining tax refunds and Earned Income Tax Credit (EITC) benefits. The IRS has been working on efforts to speed the delivery of refunds, which should help to reduce the use of traditional RALs that put cash in taxpayers' pockets within a day or two of filing the tax return. Instead of phasing out controversial tax refund loans, the RAL industry appears to be responding to the potential of faster IRS refunds by introducing a loan product that can get the "jump" on the tax filing season, allowing tax preparers and lenders to continue exploiting the tax refunds of cash-strapped low-wage workers.

Finally, with pay stub RALs, the parallels between refund anticipation lending and payday lending have become even stronger. In fact, H&R Block CEO Mark Ernst has made this argument explicitly, stating "The economics of the product have more in common with payday lending than refund lending."[1] And, Jackson Hewitt has even refused to call the product a "pay stub" loan, with its CFO Mark Heimbouch stating that "you mentioned it as a pay stub lending product. It absolutely is not. It has nothing to do with pay stub or payday lending."[2] Apparently, the term "pay stub loan" is a little too close to "payday loan" for Mr. Heimbouch's comfort.

The resemblance between pay stub RALs and payday loans is more than just the names. Both are small loans targeted at low-income consumers. Both are due in full on the next date the borrower receives money; in the case of a payday loan, the borrower's next payday. With a pay stub RAL, the single payment loan is due early in the tax return season. Both are usurious and abusive to borrowers. In fact, the tie between refund-based lending and the refund itself may become more attenuated as the industry seeks to increase the "earliness" of refund lending. There is nothing to prevent the industry from moving the time period even earlier and then having the loan paid by the tax refund months later.

Finally, the OCC's own regulations should prohibit pay stub and holiday RAL lending, because the regulations prohibit a national bank from making a consumer loan "based predominately on the bank's realization of the foreclosure or liquidation value of the borrower's collateral, without regard to the borrower's ability to repay the loan according to its terms." 12 C.F.R. § 7.4008(b). The security interest in the consumer's anticipated tax refund is tantamount to "collateral" and pay stub RAL lending does not involve a real assessment of ability to repay or debt-to-income ratios, as the value of the refund is the sole basis for issuance of the loan.

Several years ago, your office put a stop to payday lending by national banks in partnership with storefront outlets as unsafe and unsound banking with hard-to-supervise third party providers. Since there are no standards for tax preparers,[3] banks that make loans through these entities are also exposed to supervisory and compliance risks. With pay stub and holiday RALs, it would seem that some national banks are getting back into this type of abusive lending, using bank charters to enable store-front tax preparers to make loans that would otherwise violate the Internal Revenue Service's prohibition against tax preparers being the actual lender for RALs.[4] These bank/tax preparer arrangements also enable tax preparers to make loans that exceed state small loan rate caps or usury laws. We urge you to once again take action and put an end to abusive lending by national banks.

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[1] David Twiddy, *H&R Block Calls on Competitors to End "Pay-Stub" Loans*, Associated Press, June 11, 2006.

[2] Q4 2006 Jackson Hewitt Tax Service Inc. Earnings Conference Call, *Financial Disclosure Wire*, June 1, 2006.

[3] As noted by the National Taxpayer Advocate "[a]nyone can prepare federal tax returns for others for a fee regardless of his or her education, training, experience, skill, or knowledge." National Taxpayer Advocate, *FY 2003 Annual Report to Congress*, Dec. 31, 2003, at 270, available at http://www.irs.gov/pub/irs-utl/nta_2003_annual_update_mcw_1-15-042.pdf.

[4] IRS, *Publication 1345: Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns* (Nov. 2004), at 44, available at www.irs.gov/pub/irs-pdf/p1345.pdf.

Thank you for your consideration of this matter. If you have any questions about this letter, please contact Chi Chi Wu at National Consumer Law Center (617-542-8010) or Jean Ann Fox at Consumer Federation of America (757-867-7523).

Sincerely,

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(on behalf of its low-income clients)

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