



Testimony

Before the Committee on Financial Services,
Subcommittee on Oversight and Investigations
U.S. House of Representatives

**Report of Inquiry into the
FDIC's Supervisory Approach to
Refund Anticipation Loans
and the Involvement of
FDIC Leadership and Personnel**

**Statement of Fred W. Gibson, Jr.
Acting Inspector General
Federal Deposit Insurance Corporation**

March 16, 2016

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Acting Inspector General, Federal Deposit Insurance Corporation
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House Committee on Financial Services
Subcommittee on Oversight and Investigations

Chairman Duffy, Ranking Member Green, and Members of the Subcommittee:

I appreciate the opportunity to appear before you today to present the results of our work on the *FDIC's Supervisory Approach to Refund Anticipation Loans and the Involvement of FDIC Leadership and Personnel*. (Report No. OIG-16-001.)

I am submitting for the record the Office of Inspector General's Executive Summary of this report. Our Executive Summary explains why and how we conducted this work and what we learned as a result. It also raises matters for the FDIC's consideration.

Along with our Executive Summary, I am including two sets of comments from the FDIC. The first comments were received following issuance of our draft report. They are signed by the Director of the Division of Risk Management Supervision and the FDIC General Counsel and reflect the signatories' summary of the lengthier set of written comments they provided to us at that time. I received the second set of comments on the final report from the Members of the Board of Directors of the FDIC on March 11, 2016. As noted in our Executive Summary, we had requested that the Corporation advise us within 60 days from the date of our final report on the steps it would take to address the matters raised for its consideration. The Board of Directors' response outlines initial steps and indicates the Board will update our office on its progress by June 30, 2016. My office will continue to monitor the Corporation's efforts going forward.

I appreciate the Subcommittee's interest in our work and will be pleased to answer any questions you and other Members may have.

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.¹ 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

¹ 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.

tool it formerly provided to tax preparers and banks that had been used to mitigate certain risks 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 Chicago 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.

³ 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.

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 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 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.

FDIC Summary Comments on the Draft Report



Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision
Legal Division

DATE: February 17, 2016

MEMORANDUM TO: Fred W. Gibson, Jr.
Acting Inspector General

FROM: Doreen R. Eberley /S/
Director, Division of Risk Management Supervision

Charles Yi /S/
General Counsel

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

¹United 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)).

- FDIC 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 well-defined 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 RAL 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 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."³ 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 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 the review of the examination documents suggests the changes had a strong supervisory basis.

In 2010, FDIC headquarters instructed the Chicago 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.

³ 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 announced 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 Chicago 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 time⁴ – 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.

FDIC Board of Directors Comments on the Final Report



Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D. C. 20429-9990

Board of Directors

March 11, 2016

TO: Fred W. Gibson
Acting Inspector General

FROM: Martin J. Gruenberg /S/
Chairman

Thomas M. Hoenig /S/
Vice Chairman

Thomas J. Curry /S/
Director (Comptroller of the Currency)

Richard Cordray /S/
Director (Director of the Consumer Finance Protection Bureau)

SUBJECT: Response to Office of Inspector General Report No. OIG-16-001

Thank you for the opportunity to review and respond to the final Report of Inquiry (Final 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). While the FDIC's response to the Draft Report of Inquiry on February 17, 2016, addressed the factual record, this response addresses the matters raised by the OIG for consideration.

FDIC Board Review of Policy Matters Raised in the Final Report

The OIG requested that FDIC consider the issues contained in the Final Report and apprise the OIG of any actions FDIC will take as a result. In response, the FDIC Board of Directors (FDIC Board or Board) will undertake a review of the key issues raised in the Final Report for consideration. As a starting point, the FDIC Board reiterates its commitment to the Mission, Vision, and Corporate Values of the FDIC. Additionally, the FDIC Board commits to review and consider the following matters:

- the clarity and sufficiency of parameters applied to the use of moral suasion, or its equivalents;
- the adequacy of existing vehicles for examiners and other employees to report what they believe to be inappropriate actions or direction;
- the effectiveness and timeliness of avenues of redress available to banks that believe supervisory powers are not used appropriately; and
- the governance and procedures of the Board and its committees.

FDIC Board of Directors Comments on the Final Report

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Interim Actions in Response to the Final Report

In addition to this Board-level review, the FDIC has identified a number of interim actions that may be taken now to be responsive to the OIG's concerns and further strengthen the FDIC's supervision programs.

Issuance of Internal Guidance Regarding Communication with Bankers

To further reinforce expectations that communication with bankers be clear and balanced, the Division of Risk Management Supervision (RMS) will issue a Regional Director Memorandum (RD Memo) *Best Practices: Communication and Coordination with Bank Management in Carrying Out Forward-Looking, Risk-Based Supervision*. The RD Memo will:

- set forth communication expectations and best practices for each stage of the supervisory cycle: pre-examination planning, on-site examination activity, post-examination report review, and the period between examinations;
- reinforce the importance of communicating matters involving policy or recommendations in writing on FDIC letterhead or through a report of examination and documenting all such communications in FDIC records; and
- provide expanded instructions for report of examination content and style, the focus of which will be that fact-based, diplomatic and objective language is ordinarily more effective than criticism in achieving corrective action or adoption of recommended improvements.

Enhancement of Appeals Processes

The FDIC agrees that banks should have meaningful avenues of redress if they believe supervisory powers are not used appropriately, including when the appeals process is not available. The Supervision Appeals Review Committee (SARC) guidelines were amended in 2008, after notice and comment, to modify the supervisory determinations eligible for appeal and align the FDIC's appeal procedures with those of the other federal banking agencies. Prior to 2008, the FDIC was the only federal banking agency that expressly allowed review of determinations that underlie formal enforcement actions, which are subject to a separate due process.

The FDIC Board will review and reconsider the changes made in 2008 to the SARC eligibility requirements as part of the Board-level review of the clarity and appropriateness of the roles and responsibilities of existing Board committees and the effectiveness and timeliness of avenues of redress available to banks that believe supervisory powers are not used appropriately. Additionally, RMS and the Division of Depositor and Consumer Protection (DCP) will develop a process for the review of appeals that are received but are deemed ineligible for the formal review process to ensure that any matters in the appeal that require FDIC management's attention, including employee behavior, are addressed. The process will require that such reviews be completed in a timely manner, similar to that afforded those appeals eligible for the formal process.

FDIC Board of Directors Comments on the Final Report

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Issuance of External Guidance Regarding Expectations for Communication and Handling of Disagreements

RMS and DCP will update and reissue Financial Institution Letter (FIL) 13-2011, *Reminder on FDIC Examination Findings*. This FIL:

- reinforces FDIC's expectations for communications between FDIC and bankers;
- encourages banks to provide feedback on supervisory programs and to seek clarity on FDIC findings and recommendations as necessary;
- encourages institutions with concerns about examination findings to discuss those concerns with the examiner-in-charge or to contact field office or regional office personnel;
- provides an avenue for institutions to appeal examination findings through a formal appeals process; and
- provides a confidential, neutral and independent sounding board through the FDIC Office of the Ombudsman.

Issuance of Industry Guidance on Lending Through Third Parties

In response to the findings of the Final Report and prior OIG audits, the FDIC has begun developing guidance to address the risks associated with banks making loans through third parties as well as risk management practices that would be expected of banks engaging in these activities to mitigate the risks. This new guidance will supplement and expand on the guidance contained in FIL-44-2008, *Guidance for Managing Third-Party Risk*, and will specifically address the risks associated with banks making loans through rent-a-charter relationships, agent relationships, and other third-party relationships. FDIC staff will present the guidance to the FDIC's Board of Directors for consideration. As new products and delivery channels emerge, the FDIC commits to fully consider whether the issuance of specific regulatory guidance is warranted.

Independent Review

The FDIC has hired outside counsel to conduct an independent review of the Final Report and supporting materials to advise whether there is a basis for personnel action or changes to personnel policies.

Next Steps

We appreciate the opportunity to provide a response to the Final Report. The FDIC will provide a status update of the efforts outlined above by June 30, 2016.