

## OFFICE OF THRIFT SUPERVISION

### Approval of Applications for Permission to Organize a Federal Savings Bank, Holding Company Acquisition and Related Applications

**Order No.:** 2006-07  
**Date:** March 14, 2006  
**Docket Nos.:** 18001 and H-4196,  
H-4225, H-4226

H&R Block, Inc., Kansas City, Missouri (Holding Company), H&R Block Group, Inc., Nassau, Bahamas (Group), and Block Financial Corporation, Kansas City, Missouri (Financial Corporation) (collectively, the Applicants), have applied to the Office of Thrift Supervision (OTS), pursuant to 12 U.S.C. §§ 1464(e) and 1467a(e), and 12 C.F.R. §§ 552.2-1 and 574.3, to organize and to acquire H&R Block Bank, Kansas City, Missouri (Savings Bank). The Applicants have also applied for an exemption for a management interlock pursuant to 12 C.F.R. § 563f.6 and for approval of asset purchases pursuant to 12 C.F.R. § 223.42(i). The Applicants received approval from the Federal Deposit Insurance Corporation (FDIC) on August 26, 2005, for deposit insurance for the Savings Bank's deposits under the Savings Association Insurance Fund (SAIF). Collectively, the foregoing filings are referred to herein as the Applications.

The Holding Company is the parent company of a corporate organization that provides tax services, financial advice, investment, and mortgage services, and business and consulting services primarily in the United States, with additional operations in Australia, Canada, and the United Kingdom. The Holding Company's primary business is tax preparation and filing services. The Holding Company owns all of the outstanding stock of Group, and Group owns all of the outstanding stock of Financial Corporation. Financial Corporation will own all of the outstanding common stock of the Savings Bank. A subsidiary of the Holding Company, H&R Block Financial Advisors, Inc. (Financial Advisors) is registered with the U.S. Securities and Exchange Commission (SEC) as an investment advisor and a broker-dealer. Another subsidiary of the Holding Company, RSM McGladrey Business Services, Inc. is registered with the SEC as an investment advisor.

#### **The Proposed Transaction**

The Applicants propose to establish and to operate a *de novo* federal stock savings association, the Savings Bank. The Applicants propose to capitalize the Savings Bank with approximately \$160 million, with an additional capital contribution of \$25 million by the end of

the first year of operations. The Savings Bank intends to conduct traditional thrift operations. As part of its initial organization, the Savings Bank will purchase mortgages from affiliated mortgage companies, within the first three months of its operations.

Financial Advisors offers individual retirement accounts (Express IRAs) and money market fund accounts to tax preparation customers through the company's tax offices and franchisee tax offices through a client referral process, and through its tax software, TaxCut. Customers may also submit applications for Express IRA and money market accounts using the H&R Block online (Internet) website. Financial Advisors is the custodian for both the Express IRA product and the money market fund accounts. Financial Advisors pools the Express IRA and money market funds and causes the pooled funds to be placed in unaffiliated financial institutions.

Upon opening the Savings Bank, the Applicants intend to cause the transfer of a significant portion of the present Express IRA and money market account funds to the Savings Bank, under the same arrangements as funds are placed with unaffiliated depository institutions. Thereafter, it is intended that the Savings Bank will be the custodian of new Express IRA accounts.

Mr. Terrence Dunn, a proposed director of the Savings Bank, presently serves on the board of directors of a bank holding company, UMB Financial Corporation, Kansas City, Missouri (Bank Holding Company). The Bank Holding Company is the holding company for UMB Bank, N.A., Kansas City, Missouri (National Bank). The National Bank reported in excess of \$5.9 billion in assets as of June 30, 2005. The Bank Holding Company reported total assets of \$7.0 billion as of June 30, 2005. The Applicants have applied for an exemption for the management interlock from the applicable prohibition, pursuant to 12 C.F.R. § 563f.6(b).

### **Public Comments**

OTS received numerous comment letters on the Applications. Most of the comments opposed the Applications. The comments focused principally on: the Savings Bank's potential relationships with mortgage banking subsidiaries of the Holding Company; the ability of borrowers of the mortgage banking subsidiaries to receive the best loan product for which they qualify; concerns relative to the mortgage banking subsidiaries' 2004 Home Mortgage Disclosure Act (HMDA) data; the Savings Bank's Community Reinvestment Act (CRA) activities in areas in which the Savings Bank collects deposits; a request for the Holding Company and its affiliates to cease participating in the origination of Refund Anticipation Loans (RALs); and the possibility that the Savings Bank could engage in payday and other predatory lending practices. The Applicants met informally with commenters and OTS conducted a formal meeting with the commenters and the Applicants.

### **Permission to Organize Application**

OTS may grant a federal savings association charter only: (i) to persons of good character and responsibility; (ii) if, in OTS' judgment, a necessity exists for such association in the community to be served; (iii) if there is a reasonable probability for the association's usefulness and success; and (iv) if the association can be established without undue injury to properly

conducted existing local thrift and home financing institutions. In addition, OTS must consider whether the association will provide credit for housing consistent with the safe and sound operation of a federal savings association. OTS also considers the initial capitalization of the federal savings association; and the residence and composition of the savings association's board of directors.

Further, 12 C.F.R. § 563e.29(b) provides that an applicant for a federal thrift charter must submit with its application a description of how it will meet its CRA objectives. OTS is required to take this description into account when considering the application and may deny or condition approval on CRA grounds.

With respect to character and responsibility, the Applicants and their affiliates have been the subject of settlements, fines and other disciplinary actions resulting from court proceedings brought by various claimants and other proceedings brought by self-regulatory bodies and governmental agencies. The Holding Company has settled some of the private lawsuits concerning its RAL and Peace of Mind programs. The National Association of Securities Dealers and the SEC have initiated inquiries, investigations and actions against Financial Advisors with the majority of the actions relating to conduct allegedly occurring at a discount brokerage operation prior to its being acquired by Financial Advisors.

OTS concludes that the Applicants and their affiliates have appropriately addressed the issues raised in the lawsuits and in self-regulatory and governmental proceedings and that those matters do not cause the character and responsibility of the Savings Bank's organizers to be inconsistent with approval. Financial Advisors has terminated the individual brokers who were the focus of certain of the proceedings, and has taken actions to correct any internal weaknesses at issue in the lawsuits and self-regulatory and governmental matters. Further, Financial Advisors has reviewed systems, policies and procedures, and implemented refinements to help prevent recurrences of the problem activities. A review of the backgrounds of the identified officers and directors of the Applicants and the Savings Bank revealed no other adverse information and indicated that the proposed officers and directors of the Savings Bank have adequate managerial resources to operate a federal savings association. Thus, OTS concludes that this approval criterion is satisfied.

As for the necessity for the Savings Bank in the community, the Savings Bank will commence deposit taking, mortgage lending, consumer lending and commercial lending from its Kansas City office and through the Holding Company's employee and franchisee tax professionals. The Savings Bank's proposed primary market area, the Kansas City Metropolitan Statistical Area (Kansas City MSA), has experienced approximately a 12 percent growth in population between 1990 and 2000, and approximately a 24 percent growth in deposits between 2000 and 2005 and the population and deposits are expected to continue to grow. Therefore, OTS concludes that this criterion is satisfied.

With respect to undue injury to properly conducted existing local thrift and home financing institutions, the Savings Bank will provide new competition in the local market. The Savings Bank's projected level of deposits from the Kansas City MSA in its first three years of operations

will constitute an insignificant percentage of the deposits in the Kansas City MSA. Transfer to the Savings Bank of some or all of the Express IRA and money market account funds from unaffiliated financial institutions in the Kansas City MSA will not cause undue injury because those deposits represent an insignificant portion of those financial institutions' deposits. Accordingly, OTS concludes that the Savings Bank will not cause undue injury to properly conducted existing local thrift and home financing institutions.

With respect to the reasonable probability of the Savings Bank's usefulness and success, OTS reviewed the competence and experience of the proposed management of the Savings Bank, its business plan, and its proposed capital levels. OTS concludes that the business plan is reasonable, that the Savings Bank will have adequate capital, that the Savings Bank will be able to conduct its operations appropriately, and that the Savings Bank's managerial and financial resources are consistent with a reasonable probability of success. To help ensure that the Savings Bank meets the standards for approval, OTS is imposing a number of conditions. We are imposing conditions 7 and 13 below to enable OTS to confirm that the Savings Bank is being operated properly and by qualified personnel. We are imposing conditions 5 and 6 below to help ensure that the Savings Bank operates pursuant to an OTS-approved business plan and that changes to and from such a business plan are not detrimental to the Savings Bank.

Because the Savings Bank will be controlled by the Holding Company and because the Savings Bank plans to have a number of ongoing interrelationships with its affiliates and may consider additional relationships with its affiliates, we are imposing conditions 8 and 9 below concerning such transactions and the composition of the Savings Bank's board of directors and board committees. In particular, condition number 9 reflects agency concerns about captive boards in the context of holding company structures where the Savings Bank is likely to have transactions with its affiliates and market products through affiliates, and is designed to ensure that the Savings Bank's probability of usefulness and success is consistent with approval.

In addition, in order to protect the Savings Bank from the risks posed by the Holding Company's securities activities, we are imposing conditions 10 and 11 below. These conditions are designed to ensure that the Savings Bank's probability of usefulness and success are consistent with approval.

Based on the foregoing analysis, OTS concludes that the probability of the Savings Bank's usefulness and success is consistent with approval, subject to the imposition of the conditions, which are intended to help ensure the probability of the Savings Bank's usefulness and success.

With respect to the provision of credit for housing, the Savings Bank will directly and indirectly extend credit for housing. The origination and purchase of mortgage loans will enable the Savings Bank to satisfy the qualified thrift lender test. OTS has determined that the Savings Bank will have adequate policies, procedures and controls for its lending operations. Based on the above, OTS concludes that the Savings Bank will provide credit for housing in a safe and sound manner.

With respect to capital, the Savings Bank will have substantially more initial capital than required by OTS regulations and the Savings Bank plans to be well-capitalized throughout its first three years of operations. Accordingly, OTS concludes that the Savings Bank's proposed capital levels are consistent with approval.

OTS regulations require that a majority of a *de novo* federal association's board of directors be "representative" of the state in which the association is located. OTS regulations also require that a *de novo* federal association's board of directors be diversified and composed of individuals with varied business and professional experience. Further, the regulations provide that, except in the case of a *de novo* federal association that is wholly owned by a holding company, no more than one-third of a *de novo* federal association's board of directors may be in closely related businesses. Based on the residency and experience of the Savings Bank's proposed directors, OTS concludes that the Savings Bank's proposed board of directors meets the first two criteria. Because the Savings Bank will be a wholly owned subsidiary of the Holding Company, the third criterion is inapplicable.

The Savings Bank's proposed charter and bylaws substantially conform to the model federal stock charter and bylaws.

With respect to the CRA and OTS' CRA regulations, the Savings Bank's initial CRA assessment area will consist of the Kansas City MSA. The Savings Bank intends to meet the borrowing needs of its assessment area through residential mortgage lending, including lending to low- and moderate-income income persons and neighborhoods in the Kansas City MSA. To supplement its initial CRA area initiatives, the Savings Bank plans to designate Priority Areas<sup>1</sup> outside of the Kansas City MSA by identifying at least three such Priority Areas within nine months of opening the Savings Bank and by establishing lending and investment targets for those Priority Areas.

OTS received comments objecting to the Applications on CRA and other grounds. The comment letters opposing the Applications focused on several principal concerns. Commenters were concerned that the Savings Bank's relationship to the Applicants' mortgage companies could result in one or both of the Applicants' mortgage companies becoming subsidiaries or divisions of the Savings Bank. However, the Savings Bank's business plan does not include any plans for either or both of the mortgage companies to become subsidiaries of, or divisions of, the Savings Bank. Any such acquisition would either require approval under OTS' Subordinate Organization regulations, or would constitute a material change to the business plan that, for the next six years, would require prior OTS written approval. Moreover, such an acquisition, if otherwise approved by OTS, would not be prohibited under the Home Owners' Loan Act (HOLA).

Commenters expressed concerns about the ability of the mortgage companies' borrowers to receive the best loan product for which they qualify ("referral up" process). OTS' eligibility examination of the Applicants, which included reviews of the mortgage companies, did not reveal

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<sup>1</sup> Priority Areas represent geographic areas with relatively higher concentration of customer deposits and/or areas with business significance to the Savings Bank or its affiliates.

any significant problems with respect to borrowers receiving the best rates available for the type of loan sought. Further, the Holding Company has committed to improving procedures to ensure the proper operation of the “referral up” process.

Commenters alleged that the Applicants’ mortgage companies’ HMDA data reflected discriminatory lending practices. The Applicants’ responded that HMDA data does not take into account credit history, credit rating, loan-to-value ratio, and other information that is crucial to sound mortgage loan underwriting. The Applicants state that the mortgage companies’ underwriting is racially neutral, with all loans priced according to risk. OTS reviewed the Applicants’ HMDA data and reviewed the operations of the Applicants’ mortgage companies, and found no evidence of predatory or discriminatory lending practices.

Commenters asserted that the Savings Bank’s CRA plan was incomplete in part because the CRA assessment area excluded California. Commenters requested that the CRA area be expanded to include all areas where the Savings Bank will generate deposits. OTS has concluded that the Applicants appropriately selected the Kansas City MSA for the Savings Bank’s CRA market. As noted above, the Savings Bank will designate at least three Priority Areas outside of the Kansas City MSA within nine months of opening the Savings Bank and establish lending and investment targets for those Priority Areas.

Commenters were concerned about the Holding Company’s and its affiliates’ roles in originating RALs and purchasing participations in RALs. There are no plans for the Savings Bank to participate in the RAL program. The Applicants believe that the RAL program offers a valuable service to tax preparation customers and all fees and interest rates are disclosed to the tax preparation customer. The Holding Company and its affiliates may assist customers in applying for such loans provided the Holding Company or its affiliates do not make the loans. The Holding Company has asserted that enabling customers to receive such loans is necessary for competitive reasons.

Commenters expressed concerns about the Savings Bank’s potential to engage in payday lending activities, based upon the Holding Company’s and its affiliates’ existing relationships with check cashing entities. Commenters requested the termination of the existing relationships with such check-cashing partners. The Savings Bank’s CRA Plan states that it will not offer payday or other high cost lending products and will screen for predatory lending practices. As noted above, any material changes in the business plan for the first six years of the Savings Bank’s operations will require prior written OTS approval.

Commenters asserted that the Holding Company and its affiliates should: (i) commit not to offer “bounce protection” with its checking accounts; (ii) offer a low or no cost checking account; (iii) limit ATM fees to customers; (iv) institute reforms to its privacy practices to protect the confidentiality of sensitive customer information; and (v) provide certain services free of charge. The Holding Company addressed the concerns and committed that the Savings Bank would not offer “bounce protection,” would develop a bank account product for low-income persons, would limit ATM charges to customers, and would enhance procedures to ensure the confidentiality of personal information.

Based on the Savings Bank's CRA Plan and the Applicants' responses, OTS concludes that the Savings Bank has satisfactorily demonstrated that it will meet its CRA objectives, and that the comments did not warrant rejection of the CRA plan, the imposition of additional conditions of approval, or cause the Applications to fail any relevant approval criterion for any of the Applications.

### **Holding Company Application**

Section 10(e)(1)(B) of the HOLA and the Acquisition of Control Regulations thereunder provide that OTS must approve a proposed acquisition of a savings association by a company, other than a savings and loan holding company, unless OTS finds that the financial and managerial resources and future prospects of the company and association involved would be detrimental to the association or the insurance risk of the SAIF. OTS must also consider the impact of the acquisition on competition. Finally, OTS must take into account assessments under the CRA when considering holding company applications.

For the reasons set forth above, OTS concludes that the managerial resources of the Applicants and the Savings Bank are satisfactory, subject to the conditions discussed above regarding management and the board of directors. To the extent that the matters described in the managerial resources discussion of the permission to organize application section are presumptive disqualifiers, OTS concludes that such presumptive disqualifiers have been rebutted for the reasons set forth therein.

With regard to financial resources, OTS reviewed the Applicants' financial position and the Savings Bank's proposed capitalization and business plan. The Applicants demonstrated adequate resources and operations. The application projects that the Savings Bank will meet all of its capital requirements and will be well capitalized, as defined in the OTS Prompt Corrective Action regulation throughout the first three years of operation. Based on the foregoing, OTS concludes that the financial resources of the Applicants and the Savings Bank are consistent with approval of the holding company application.

Based on the factors considered in the above discussions regarding the managerial and financial resources of the Savings Bank and the Applicants, the character and responsibility of the officers and directors of each entity, and the probability of the Savings Bank's usefulness and success, OTS concludes that the future prospects of the Applicants and the Savings Bank are consistent with approval, and will not pose undue risk to the SAIF, subject to the imposition of the above recommended conditions.

The transaction will not result in any currently operating, unaffiliated depository institutions becoming affiliated. Accordingly, OTS finds no basis for objection to the transaction on anti-competitive grounds.

With respect to the Applicants' performance under the CRA, the Applicants have not been subject to the CRA. Accordingly, OTS concludes that there is not any basis for objection to the holding company application based on CRA grounds.

### **Management Interlocks**

Mr. Terrence Dunn, a proposed director of the Savings Bank, serves on the Board of Directors for the Bank Holding Company. OTS' Management Interlocks Regulation (Interlocks Regulation) generally prohibits a management official of one depository organization from serving as a management official of an unaffiliated depository organization if the total assets of the first depository organization exceed \$2.5 billion and the total assets of the other unaffiliated depository organization exceed \$1.5 billion. However, the Interlocks Regulation permits OTS to exempt an interlock from the general prohibition if OTS finds that the interlock would not result in a monopoly or substantial lessening of competition and would not present safety and soundness concerns. OTS applies a rebuttable presumption that an interlock will not result in a monopoly or substantial lessening of competition if, as here, the depository institution seeking the exemption has been chartered two years or less. If OTS grants an interlock exemption in reliance on such presumption, the interlock may continue for three years, unless otherwise provided by OTS in writing. The Applicants have requested, on behalf of the Savings Bank, an exemption for Mr. Dunn's proposed dual service. OTS concludes that the Savings Bank's operations should not result in a monopoly or result in a substantial lessening of deposits in the Kansas City MSA. The presumption that the interlock will not adversely affect competition has not been rebutted. OTS has no supervisory objection to the interlock. OTS grants the requested exemption for the three-year period. OTS is imposing condition number 12 below to ensure that the proposed interlock will not violate the Interlocks Regulation after the initial three year period ends.

### **Transactions with Affiliates**

The Savings Bank proposes to purchase approximately \$850 million of mortgages from one or both of the Applicants' mortgage companies within the first three months of the Savings Bank's operations. Section 223.42(i) of the Federal Reserve Board's Regulation W excepts asset purchases by a newly formed member bank<sup>2</sup> from an affiliate from the restrictions of Regulation W, except for the safety and soundness requirements of section 223.13 and the market terms requirement of section 223.51, if OTS approves the asset purchase in writing in connection with its review of the formation of the member bank. The Applicants have requested such approval. OTS concludes that the Savings Bank has proposed adequate loan policies and procedures for the origination and purchase of loans that should help ensure the safe and sound operations of the Savings Bank. OTS also believes that the Savings Bank's plan to purchase the loans is a reasonable strategy to begin operations. Therefore, OTS approves the proposed bulk asset purchases in connection with the formation of the Savings Bank.

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<sup>2</sup> For OTS purposes, the reference in Regulation W to "member bank" applies to savings association. See 12 C.F.R. § 563.41(b) (2005).



## Conclusion

Based on the foregoing, OTS concludes that the Applications satisfy the applicable approval standards, provided that the following conditions are complied with in a manner satisfactory to the Midwest Regional Director (Regional Director). Accordingly, the Applications are hereby approved, subject to the following conditions:

1. The Applicants and the Savings Bank must receive all required regulatory approvals prior to consummation of the proposed transaction with copies of all such approvals provided to the Regional Director;
2. The proposed transaction must be consummated within 120 calendar days from the date of this Order;
3. On the business day prior to the date of consummation of the proposed transaction, the chief financial officers of the Applicants and the Savings Bank must certify in writing to the Regional Director that no material adverse changes have occurred with respect to the financial condition or operation of the Applicants and the Savings Bank, respectively, as disclosed in the Applications. If additional information having a material adverse bearing on any feature of the Applications is brought to the attention of the Applicants, the Savings Bank, or OTS since the date of the financial statements submitted with the Applications, the transaction must not be consummated unless the information is presented to the Regional Director, and the Regional Director provides written non-objection to consummation of the transaction;
4. The Applicants and the Savings Bank must, within 5 calendar days after the effective date of the proposed transaction: (a) advise the Regional Director in writing of the effective date of the proposed transaction and of the Savings Bank's insurance of accounts; (b) advise the Regional Director in writing that the transaction was consummated in accordance with all applicable laws and regulations, all materials provided by the Applicants during the application process, the Applications, and this Order; and (c) provide a reconciliation of the Savings Bank's capital to the Regional Director;
5. The Savings Bank must operate within the parameters of a six-year business plan. Prior to the end of the first three years of operations, the Savings Bank must submit a new or updated business plan for an additional period of at least three years for the prior, written non-objection of the Regional Director. The Savings Bank must submit any proposed major deviations or material changes from the business plan (including those initiated by the Applicants) for the prior, written non-objection of the Regional Director. The request for change must be submitted a minimum of 60 calendar days before the desired implementation date with a copy to the FDIC Regional Office;

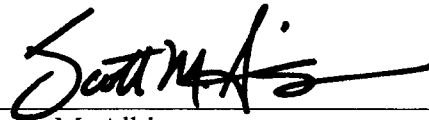
6. For six years following the Savings Bank's commencement of operations, the Savings Bank must submit to the Regional Director within 45 calendar days after the end of each calendar quarter, a business plan variance report detailing the Savings Bank's compliance with the business plan and an explanation of any material deviations;
7. For two years following commencement of operations, the Savings Bank must receive the prior written non-objection of the Regional Director for any proposed new directors or senior executive officers or any significant changes in responsibilities of any senior executive officer;
8. For eighteen months following the Savings Bank's commencement of operation, any contracts or agreements pertaining to transactions with affiliates not yet submitted to the OTS for review, or any material changes to previously submitted contracts or agreements, must be provided to the Regional Director for his written non-objection at least 30 calendar days prior to their execution and implementation;
9. At least 40 percent of the Savings Bank's board of directors must be individuals who are not officers or employees of the Applicants or affiliates thereof, and who have not otherwise been determined by the Regional Director to lack sufficient independence. At least one member of the Savings Bank's board of directors must be an individual who is not an officer, director or employee of the Applicants or any affiliate, and who is not an officer or employee of the Savings Bank, and who has not otherwise been determined by the Regional Director to lack sufficient independence. At least 50 percent of any audit and loan committees established by the Savings Bank must be directors who are not officers or employees of the Savings Bank, the Applicants or any affiliates, and who have not otherwise been determined by the Regional Director to lack sufficient independence;
10. A majority of the Savings Bank's board of directors must not be individuals who are officers, directors or employees of any affiliate of the Savings Bank that engages in broker, dealer, investment company, or investment advisor activities (Securities Affiliate);
11. The Savings Bank and any Securities Affiliate are prohibited from sharing common officers, unless prior approval is obtained from the Regional Director, which shall be based on criteria such as regulatory compliance, experience, character, integrity and the ability to perform both duties;
12. Within three years after the date of the Savings Bank's opening, Mr. Terrence Dunn must either resign as a management official of the Savings Bank or the Bank Holding Company, or file an exemption for, and receive the prior written approval to continue, the interlocking management official relationship; and

13. The Savings Bank must submit independent audit reports to the Regional Director for its first three years of operations. These reports must be in compliance with the audit rules set forth at 12 C.F.R. § 562.4.

The Regional Director may, for good cause, extend any time period set forth herein for up to 120 calendar days.

By order of the Director of the Office of Thrift Supervision, or his designee, effective

March 14, 2006.

A handwritten signature in black ink, appearing to read "Scott M. Albinson", written over a horizontal line.

Scott M. Albinson  
Managing Director  
Office of Examinations, Supervision,  
and Consumer Protection